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The Regulatory State: Ensuring its Accountability

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Note: Evidence received by the Committee is published in two separate volumes: Vol. II, Oral Evidence (HL 68-II); and Vol. III, Written Evidence (HL 68-III).

In the text of the report:

- Q. refers to a question in the oral evidence;
- p. refers to a page in the written evidence; and
- para. refers to a paragraph number in this report.

The Regulatory State: Ensuring its Accountability

CHAPTER 1: INTRODUCTION AND SUMMARY

1. As nationalised industries were privatised at the end of the twentieth century, industry regulators were appointed to encourage competition and to protect the consumer. Regulators are notable now not only for their number but also for their powers. These include imposing penalties, levying fines, and creating secondary legislation. Regulators have frequently been able individuals who have used their powers effectively to achieve their goals. However, their existence and the exercise of their powers have not been free of controversy. The regulatory regime is now substantial. There are significant costs of complying with regulation. The smaller the regulated body, the greater the burden. Decisions of some regulators have proved unpopular and on occasion brought them into dispute with bodies set up to represent consumer interests. Some critics query the continuing need for a state-imposed regulatory regime.
2. The existence of regulators also raises fundamental questions of accountability. They are appointed by ministers in order to achieve certain policy objectives. Ministers are accountable to Parliament, individually and collectively. Regulators are appointed in order to be at arm's length from Government in fulfilling their functions. Though created by statute and appointed by ministers, they exist essentially as independent agents.
3. Given this, the question arises as to how the performance of regulators is monitored to ensure that the public interest is properly served. To what extent are regulators accountable to the citizen? To what extent do they take into account the public interest, consumer interests, and the interests of the bodies they regulate, and how do they gauge such interests? To what extent are they answerable for their actions to Parliament? We therefore decided to inquire into the workings of Government-appointed regulators; the extent to which their activities are monitored by Parliament; their accessibility to the public and the regulated; and their responsibility to the citizen and those whom they regulate.
4. Our starting point is that regulation is a means to an end, not an end in itself. Regulation can only be in the public interest where it serves a clear purpose. We question the apparent assumption that the present level of regulation, let alone an even greater extension of quasi-Governmental powers, should remain a permanent feature of our polity. We have to resist the danger of regulatory creep. Many judge that regulatory burdens are increasing, sometimes unnecessarily. This regulatory tendency has to be checked, and the best means is effective accountability. Necessary, and cost-effective, regulation can then be properly identified; unnecessary regulation can, and should, be removed.

Context

5. Our Inquiry should be seen in the context of the very significant changes made to the machinery of Government and the institutional structures for

regulatory decision-making over recent years and decades. The most important is at the heart of our study: the establishment of the independent regulators, acting at arms-length from ministers, empowered and constrained by their own statutory authority but often responsible for issues hitherto dealt with by government departments. Traditional mechanisms of accountability may therefore have to be reinforced, or reviewed and adapted, where necessary, to the new arrangements.

6. There have also been progressive and prospective changes to the rights of the regulated in recent years, perhaps most clearly exemplified by the incorporation of the European Convention of Human Rights into UK law. This has had direct and indirect effects. Recent legislation, such as the Communications Act 2003, incorporates European Directives which pay full regard to the philosophy of appeals being made on the merits of the case, and with those appeals being heard by independent tribunals. Citizens also have higher expectations as to their rights concerning the due accountability of regulators for their decisions. We can only expect the progressive consolidation of those rights and expectations into law and judicial review procedures to continue.
7. The issue of regulation has itself been a matter of Governmental concern. Regulatory reform has been high on the agenda, now focusing on better regulation rather than simply deregulation, and improving regulatory accountability has been an integral part of that agenda. So, for example, regulatory reform orders have been introduced, and statutory duties have been extended, with codes of practice put in place, to improve the transparency of regulators' roles, responsibilities and decision-making. The question for the Committee has therefore been how effective is regulatory accountability, mindful of the on-going changes and developments, and how can it be strengthened?

Who does what and why?

8. We sought first to establish for what, and to whom, regulators are and should be accountable. We conclude that regulators should be accountable for cost-effective regulation which meets rational, well-defined objectives. This approach brings together the 'why' and 'how' issues of regulation. We take a wide view of the accountability of regulators to all interested parties, but note that in practice it will be exercised in different ways, appropriate to different circumstances.
9. We then focused on the processes by which this accountability is given effect. The three key elements we identify are:
 - the duty to explain;
 - exposure to scrutiny; and
 - the possibility of independent review.

The last two are the means through which regulators are required to answer to public bodies for their actions. In addressing change, we have sought to distinguish between reforms which have been directed at improving the design of regulation, and reforms which are aimed at improving accountability for regulatory decisions. We have not found a conflict between independence and accountability.

Conclusions

10. Effective processes for achieving accountability are a key discipline on regulators, and are essential to maintaining both an effective regulatory framework and effective regulatory decision-making. Accountability is a control mechanism which is an integral part of the regulatory framework. Effective regulation therefore requires effective accountability. The preparation of regulatory impact assessments (RIAs) is an important discipline on regulators. Properly done it reveals whether regulators have subjected their decisions to cost-benefit analysis in order to achieve both balance and cost-effective regulation. These RIAs need to be conducted retrospectively as well as prospectively, to ensure that cost-effectiveness is constantly under review.
11. We welcome the improvements made in recent years, but more needs to be done in order to achieve a sustainable system. In particular, the Government's approach is departmentalised and insufficiently co-ordinated. This militates against accountability. It should instead be interdepartmental and fully co-ordinated. We make fifteen recommendations in this area, aimed at ensuring that the Government maintains a consistent, focused and proactive role towards achieving cost-effective regulation, where that regulation is needed.
12. There have been notable improvements in the transparency of, and hence in accountability for, the processes by which regulatory decisions are made; but efforts should be made to ensure that regulators improve access to the consumer, especially through consumer groups. The most urgent need for reform, however, is in respect of parliamentary scrutiny and independent review.
13. Improving parliamentary scrutiny is essential. It is not just a question of the answerability of regulators to Parliament, but also one of the duty of Parliament to ensure that its scrutiny is effective. As with Government, Parliament lacks the mechanism for consistent and coherent scrutiny of regulation. Scrutiny at the moment is dependent on individual committees deciding that inquiry is necessary into a particular regulator or regulatory decision. It is thus both fragmented and inconsistent. There is no means of establishing a coherent overview of the regulatory regime operating within the United Kingdom. We believe there should be.
14. We have been mindful of the need to maintain the appropriate balance between the needs of regulation in the public interest and the rights of the regulated. This is most important when considering possible reform of appeal mechanisms, on which there are contrasting views. Our view is that the power of the regulatory state needs to be matched by effective rights of appeal based on the merits of the case. The only right of appeal open to many regulated bodies is the very restricted one of judicial review. This is normally expensive, time consuming and narrow. Delays leave the regulated in a state of potentially costly uncertainty. For many, therefore, it is not a viable option. We believe that there must be a more accessible and efficient appeals mechanism.
15. Our inquiry has been a major one, and we are indebted to all of those individuals and organisations who have submitted evidence in person or in

writing.¹ The amount of evidence reflects the extent of concern about the existing regulatory state. Our overall judgement is that the increased emphasis on the accountability of regulators in recent years is to be welcomed and should be strengthened. Accountability has improved, is improving, and must continue to improve. Our Inquiry and its recommendations are directed to that end.

Recommendations

16. The recommendations have been ordered by reference to four categories: those related to the Government's and Parliament's responsibilities for the regulatory framework as a whole, and those related to the three specific elements of accountability which control the regulators, being the duty to explain, exposure to scrutiny and the possibility of independent review.

The overall regulatory framework

- (1) Independent consumer bodies should be obliged by statute to engage in open meetings and conduct regular surveys of consumers. This has resource implications which should be met out of public funds. Following a review of the budgetary arrangements for each regulator, an appropriate formula should be agreed for calculating this provision and applied to each of these bodies. We believe that these changes will enhance both the accountability and the independence of the consumer bodies. (para 69)
- (2) We are aware that the Government is undertaking a review of consumer bodies, supported by the National Audit Office (NAO), and recommend that the review includes an examination of the relationship between regulators and the related consumer bodies in order to introduce greater clarity in the relationship, if necessary through a statutory provision common to the regulatory regime. (para 70)
- (3) We welcome the move towards more collective board structures, rather than sole regulators, as one of the principal mechanisms for improving the quality and consistency of regulatory decision-making, and urge that this should be the norm for regulatory regimes. To ensure that there is no loss of accountability we recommend that boards designate one of their number as the public face of the regulator in order not to lose engagement with the public and to perform the role of building confidence and understanding. Normally this should be the Chairman or Chief Executive. Where appropriate open meetings should be held as a means of increasing public understanding and confidence. (para 110)
- (4) Government should explicitly accept overall responsibility and accountability for regulatory policy and the regulatory framework, while devolving responsibility under defined circumstances to independent regulators. (para 122)
- (5) Ministers should remain responsible for appointing regulators, subject to Nolan rules, to ensure proper responsibility and accountability. (para 126)

¹ See Volumes II and III

- (6) Regulatory legislation should normally be drafted in the light of consultation with regulators to achieve clearly defined objectives. The duties imposed on regulators should be consistent with the overall remit of the regulator (for example, economic regulation). They should make clear the underlying purpose of the regulator's role (such as consumer protection). (para 130)
- (7) Responsibility for environmental and social standards should normally remain with Ministers as the authority of a democratic mandate is required for decisions in these areas. (para 138)
- (8) The OECD regulatory checklist should be utilised as standard for legislation, regulatory decision-making and in establishing any new regulator. (para 142)
- (9) The recommendation of the Better Regulation Task Force (BRTF) that regulators should produce Regulatory Impact Assessments (RIAs) on all new major policies and initiatives has been accepted by the Government and should be applied throughout the system. We also endorse the Task Force's recommendations, among others, aimed at increasing the transparency and accountability of regulators, including open meetings and agreeing a management statement with the sponsor Department. (para 146)
- (10) The BRTF should review its principles of good regulation to ensure that the principles of coherence, objectivity and rationality of approach are incorporated and signalled to the wider public. (para 148)
- (11) There must be a much stronger communication of the 'whole of government' view of regulation. We recommend that the Government appoint a lead Department to be responsible for promoting effective regulation in practice, thereby co-ordinating the various roles currently played by a number of Departments, including HM Treasury, DTI, the Cabinet Office and the Office of the Prime Minister. Logically, the Cabinet Office should assume this role, possibly by expanding the remit of its RIA unit. Its responsibilities should mirror those we outline for a parliamentary committee in paragraphs 199 to 203. (para 152)
- (12) There should be consistency in applying regulatory models and requirements on a like-for-like basis. (para 153)
- (13) The move towards self-regulation should be encouraged and co-regulation should, where appropriate, be used as a preliminary to it. (para 157)
- (14) Regulators should have a statutory duty to have regard to the principles of good regulation and effective accountability. These should include self-assessment of their compliance with the same; the design of effective consultation procedures to engage interested parties; ensuring that redress and compensation procedures are clear and accessible; and incorporating the outturn of plans in their annual reports. They should also include the publication of the following:
 - (a) their mission statements;
 - (b) codes of practice for the conduct of their regulatory office;

- (c) codes of practice for consultation (including the duty to summarise and accept or rebut consultees' comments, with reasons);
 - (d) their forward plans;
 - (e) the explanations of and reasons for their decisions; and
 - (f) all relevant material necessary for their production before and after RIAs. (para 169)
- (15) Regulators should adopt a structured approach to consultation designed to minimise the burdens on those consulted and to facilitate their engagement with either the principles or the detail as appropriate to the interests of those consulted. (para 173)

Exposure to scrutiny

- (16) A dedicated parliamentary committee should be established to scrutinise the regulatory state. (para 199)
- (17) This should preferably be a joint committee of both Houses and should be given the necessary resources to fulfil its task effectively. (para 200)
- (18) We recommend that select committees consider expanding their terms of reference to include a requirement routinely to consider and react to regulators' annual reports, and monitor the use of resources. These activities would be in addition to the *ad hoc* inquiries they undertake from time to time. (para 202)
- (19) In order that parliamentary scrutiny by select committees can be more consistent and co-ordinated, it should be focused around the annual report and the published RIAs, and with specific attention paid to a harmonised whole of government view of regulation. (para 203)
- (20) The NAO should have access consistently to all regulatory bodies, including the Financial Services Agency (FSA), with a view to monitoring their cost-effectiveness and budgetary control. (para 212)
- (21) We welcome the expansion of the role of the NAO and recommend that the annual review of Regulatory Impact Assessments by the NAO be developed. In order to maintain the strict independence of the NAO and its scrutiny role, we recommend that this should not be undertaken as an agency of the Cabinet Office. These RIAs need to be conducted retrospectively as well as in advance, to ensure that cost-effectiveness is constantly under review. (para 218)

Independent review; improving appeals

- (22) Appeals should provide an opportunity for the regulated to have their objections reviewed on the merits of the case, subject only to the condition that the appeal body should have the clear ability and power to identify and penalise appeals designed to frustrate equitable regulation. (para 230)
- (23) Simplified systems of fast track appeals against regulatory decisions and arbitration should be developed for the Competition Commission

and the Competition Appeal Tribunal, and made available subject to the agreement of each of the parties concerned. (para 231)

- (24) We further recommend that a Regulatory Appeals Tribunal should be set up to cover regulatory decisions that do not fall within the jurisdiction of either the Competition Commission or the Competition Appeal Tribunal. (para 232)

CHAPTER 2: REGULATORY ROLES AND ACTIVITIES: ACCOUNTABILITY FOR WHAT?

Three purposes of regulation

17. The Committee received evidence about a wide range of regulators and regulatory activities.² Regulation can usefully be divided into three broad categories - economic regulation aimed at controlling the abuse of monopoly power; regulation of public goods and external effects, such as environmental pollution; and social regulation.³
18. The role of the regulatory state is therefore about much more than regulating business decisions, important as that is. The state is concerned with promoting public goods in many areas of citizens' lives – for example, promoting charitable works, culture and civil society – whilst at the same time avoiding public bads: for example, prohibiting racial abuse, theft and speeding. Regulating such non-market conduct therefore involves changing both positive and negative types of conduct. In a general sense, both can be grouped under the heading of 'non-market conduct failures', given too little of a good thing is as much a failure as too much of a bad thing. Both command the attention of Governments to consider the right way to deal with each problem, whether by regulation or some other intervention.
19. In some circumstances, the market does not operate, the most notable example being national defence. What are known as 'missing markets' are a good example of where the Government steps in as the provider of goods and services, rather than as regulator. The Government takes responsibility for providing these types of public good, although it may still contract out to the private sector for the supply of defence goods and services. Technically, these 'pure' public goods may be classified by economists as a form of market failure, but the example illustrates that the public good is the objective of Government provision or regulation, whether caused by market or non-market failures.
20. The concept of market failure is usually more directly related to negative conducts, such as deliberate anti-competitive behaviour by a company, or external effects on third parties, such as environmental pollution, but it can encompass more positive elements, such as the need to improve consumer information about markets so that the market overall works more effectively. This often involves action to correct information asymmetries between producers and consumers, including requirements for product labelling, or as between investors and company boards, related to obligations to publish financial information.
21. Income redistribution to ensure that all citizens can afford access to essential services, or the imposition of universal service obligations on the utility and network industries (water, energy, transport and communications), are other examples of state intervention to regulate what would otherwise be unacceptable market outcomes.

² See Appendix 8 for a summary of the range of witnesses by type.

³ See, for example, standard economic texts such as Richard Lipsey and Alec Chrystal, *Economics*, 10th edition (Oxford: Oxford University Press, 2004).

A broad definition of regulation

22. Regulation is achieved by decisions intended to control or influence specific elements of the regulated activity.⁴ They are implemented by the setting, monitoring and enforcement of standards designed to achieve chosen objectives. Our concern is with the accountability of regulators for those decisions and for the choice of those objectives.
23. Inspectors act as agents both of Ministers in their regulatory capacity and of independent regulators. They are accountable to the regulatory authority by which they are employed. The Office for standards in Schools (Ofsted) has the appearance of a regulator but functions as an inspectorate reporting to the Secretary of State for Education.⁵ Our focus is not on inspectors but on the accountability of the regulatory authorities themselves. They are also subject to a form of inspection. The National Audit Office (NAO) can audit their accounts and report on their procedures and practices. While this provides them with an incentive to seek efficiency and best practice it does not impact on their policy decisions and is not, therefore, the subject of our enquiry.
24. The Better Regulation Task Force has provided a broad definition of regulation to accompany its five principles of good regulation. It states that “Regulation may widely be defined as any measure or intervention that seeks to change the behaviour of individuals or groups”. The BRTF illustrates this definition by going on to say “it can both give people rights (eg equal opportunities) and restrict their behaviour (e.g. compulsory seat belts),”⁶ in effect saying that any action by a Government body or its equivalent in carrying out certain public functions which aim to change behaviour is regulation. Publishing league tables which affect behaviour can then properly be seen as a form of regulation, and the regulators who use them should be accountable for their decision to use them. However, this type of regulatory decision can clearly be distinguished from a formal decision affecting an individual or organisation, and which requires them to take, or stop, a specific action (a binding decision).
25. A broad definition is helpful because it focuses attention on the key issue for our Inquiry, which is that regulators should be accountable for their decisions and actions, judged against the purpose for those decisions and actions (i.e. the why of regulation), and the appropriateness of those decisions (i.e. the how of regulation). This involves questions of statutory authority and the effectiveness of the particular regulatory instruments chosen. Statutory functions and the powers and duties of regulators must therefore be the starting point for addressing the accountability of regulators. As to the why of regulation, the reason for making regulatory decisions is to achieve better outcomes. The question of ‘accountability for what?’ can therefore be answered: accountability of regulators for achieving good regulation through effective regulatory performance in practice. How regulation is carried out is therefore a key focus for scrutiny.

⁴ The Oxford English Dictionary defines to regulate as “to control, govern or direct by rule or regulations; to subject to guidance or restrictions...to adjust...with reference to some standard or purpose”.

⁵ As we have noted previously, “the Education (Schools) Act 1992 had established a new schools inspection system, and made provision for the publication of school ‘league tables’”, *House of Lords Select Committee on the Constitution, Annual Report 2002-03, 2nd report 2003-04*, HL paper 19, p. 19, para 21.

⁶ Better Regulation Task Force, *Principles of Good Regulation* (2003), p. 1, paragraph 1.

26. Regulators have made it clear in their evidence that their regulatory functions are the responsibility of Parliament, since they are created by statute, and therefore carry out only regulatory functions designed and passed into legislation by Parliament.⁷ For example, Philip Fletcher, the water regulator, put it clearly and succinctly: “We are creatures of statute and work within that framework, subject to judicial review of our actions”.⁸
27. The Department for Trade and Industry (DTI), which has general responsibility for co-ordinating economic regulation across Government, confirmed this basic fact, notwithstanding the different histories of the development of regulation in each sector: “Despite establishment at different times and in different ways, the regulators share a basic model: a sector specific regulator charged with a responsibility to operate under a hierarchy of statutory duties to achieve a range of public policy objectives”.⁹
28. The DTI also confirmed that whilst Parliament sets the statutory framework, the statutory duties are framed in such a way as to allow necessary flexibility and discretion to independent regulators in the exercise of their functions: “The statutory objectives of the regulators are expressed as general duties. Some of these duties express matters which are to be achieved through the exercise of the regulators’ functions, others identify issues or concerns which the regulator must take into account when exercising its functions. In some cases, though not all, one or more of the duties is identified as having primacy or precedence over other duties”.¹⁰
29. As regulation starts with Parliament, the ultimate responsibility for regulation rests with Parliament. This sets regulatory accountability in a broader setting, which starts with parliamentary responsibility for establishing the right legislation and ends with effective parliamentary scrutiny of both process and outcomes, whilst at the same time recognising a hierarchy of regulation: regulatory responsibility might in some cases be devolved formally, or informally, to Government appointed regulators for executive implementation of regulation. The question of the independence of regulators, and the impact that has had on their accountability, is therefore important, and one on which the Committee received much evidence.

Accountability for effectiveness (regulatory outcomes)—the why and how of regulation

30. Accountability for effectiveness has therefore to be considered in two parts. First, what are the purposes, or outcomes, to be achieved by regulation in terms of addressing market or conduct failures (the outputs of regulation)? Secondly, how has regulation been carried out to achieve those outcomes (the inputs of regulation)? Was regulation done well or badly? If done badly, is it the fault of the specific regulator, or a systemic fault in the design of the regulatory system and the statutory powers and duties under which the individual regulator operates, for which Government and Parliament must then take responsibility? In principle, regulation should be proportionate, in

⁷ For the development of regulators and their functions, see Appendix 9. See also the annexes to the written evidence of the DTI (Vol.II pages 378-389).

⁸ Vol. II p197

⁹ Vol. II p372

¹⁰ Vol. II p373. See also annex 1 of DTI submission for summary of duties of economic regulators (Vol.II pp 378-383).

that it achieves the desired outcome in the most effective and least burdensome way. In short, effective regulation is cost-effective regulation, where cost is used in a general sense. The why and how of regulation have therefore to be taken together in addressing the question, accountability for what?, so that our focus is on achieving effective regulation and the means by which accountability helps achieve that end.

31. These questions - and the burden of regulation - were at the heart of much of the evidence we received from the regulated. The UK mobile operators told us that whilst “we are one of the biggest success stories of policy and market liberalisation in this country...we are very highly regulated and therefore regulation is a very significant constraint in what we do in our commercial and competitive activities”.¹¹ The burden of regulation came up repeatedly, including the volume of consultation. The Royal Mail told us “...sometimes there has been almost too much consultation on some issues. For example, Postcomm’s powers are such that we cannot alter the terms and conditions of one of our services to even the smallest extent without their agreement unless we can show that it is for the benefit of the customer. This has resulted in delays of six, seven, eight, nine months to try and effect even the smallest change to our terms and conditions. ... There has to be proportionality - more consultation for big issues where there is a real political dimension”.¹² BAA told us of ‘regulatory creep’, which has increased the burdens: “However, the light touch approach has suffered progressive deterioration, as five-yearly reviews have expanded from 12 months to 32 month investigations, with significant duplication of effort between the CAA and the Competition Commission.... Regulation has therefore become a significant burden and distraction to all parties, including BAA’s airline customers”.¹³
32. The burden of regulation can particularly affect small businesses, as we were repeatedly told by firms of financial advisers: “The FSA Handbook is vast and almost incomprehensible - the only way to look at it is via the search engine on the FSA website as apparently if printed out it would stand 9 feet high!”¹⁴ There was therefore a considerable emphasis in the evidence we received for a greater focus on deregulation. Scottish and Southern Energy plc told us “The fact that Ofgem is such a high-cost organisation, with regulatory activity seeming to increase in inverse proportion to the number of activities actually regulated, implies that it warrants detailed scrutiny and analysis of its effectiveness. This is amplified by the absence of basic standards of performance”.¹⁵ The UK mobile operators identified a lack of trust in the market, telling us that “to some extent we have to trust the market. I do not think recently there has been much trust of the market. As soon as a problem pops up someone feels that they have to go and deal with it rather than saying ‘that is how competition works, when there is a problem competition deals with it’. If you always regulate all of the problems away you are never going to get rid of regulation”.¹⁶ Innogy noted that Ofgem “has made progress towards removing regulation in some areas, but would now like to

¹¹ QQ1165 & 1167, Vol II p436

¹² Q643, Vol.II p234

¹³ Vol.III p14, paras 3 and 4.

¹⁴ Vol.III p180

¹⁵ Vol.III p157

¹⁶ Q1168, Vol.II p437

see a more concerted effort to review detailed sectoral regulation. Non-regulatory options should be examined before further regulation is introduced and, where competition is effective, Ofgem should rely on enforcement by competition law”.¹⁷

The roles of Parliament, Ministers and independent regulators

33. The third aspect, alongside a broad definition of regulation and consideration of the effectiveness of how regulation has been carried out, is the inter-related responsibility of Parliament, ministers and independent regulators. Each plays different parts at different times - more or less independently, but is orchestrated within an overall framework for an effective regulatory state which achieves cost-effective outcomes for citizens, and operates in the public interest.
34. Parliament sets the statutory framework embodying the objectives to be achieved by regulation. It legislates, however, for that regulation, in many cases, to be carried out by independent regulators. The reason has been well summed up by the OECD: “The key benefits sought from the independent regulatory model are to shield market interventions from interference from ‘captured’ politicians and bureaucrats”.¹⁸
35. Independent regulators must therefore be held accountable for their actions, but independence is not fixed in stone, and Government and Parliament retain responsibility to review regulation and ensure that the legislation remains fit for purpose. It can therefore be expected that Parliament will change the legislation from time to time. The DTI made reference to this in its evidence: “The primary means by which the regulators’ role may be changed is through parliamentary amendment of the duties specified in the statutory framework. The role of regulators has been changed in this manner over time”.¹⁹
36. The water industry regulator has provided us with a clear example, which also illustrates the relationships between various regulators. Standards of drinking water, and for discharges of used water back into the environment, are the responsibility of ministers, supported by the expert advice of the Drinking Water Inspectorate (DWI) and the Environment Agency (EA) respectively (whilst noting that the Minister’s decision itself might reflect the incorporation into law of a European Directive on the subject). These two bodies advise Ministers but are not accountable in that role for the Minister’s decision, which is incorporated appropriately into law. As regulators, however, they carry out functions of inspection (monitoring) and enforcement where the standards set by Ministers, and approved by Parliament, are not being met. The regulators may have discretion as to when and how they exercise their powers.
37. Once the Minister has set (or been minded to set) certain standards, the economic regulator in England and Wales (the Office of Water Services, supporting the Director General or, as now, Authority, following the Water Act 2003) is responsible for protecting customers’ interests by controlling the

¹⁷ Vol.III p105

¹⁸ Regulatory Policies in OECD Countries - From Interventionism to Regulatory Governance, p. 97: Reviews of Regulatory Reform (Paris: OECD, 2002).

¹⁹ Vol.II p373

abuse of monopoly power which might otherwise be exercised by private sector water service providers. His statutory duties include customer protection, ensuring that all reasonable demands are met, and the duty to ensure that the regulated water service providers carry out their proper functions (for which they have been granted a licence) and can finance themselves. His regulatory role is independent of Ministers and set out in statute. The key regulatory decisions relate to setting maximum price controls for each water service provider for a period of years, typically five years. This decision has, however, to allow the regulated companies the financial wherewithal to maintain the quality standards set down by Ministers. Environmental and quality regulation is therefore incorporated as a constraint into economic regulation.

38. The balance between standards and affordability is debated as part of the deliberative cycle of the periodic review, involving the Department of the Environment, Food and Rural Affairs (DEFRA), Ofwat, the Electricity Association (EA) and the industry. The cycle has been formulated into an explicit timetable for submission of draft and final business plans by the regulated companies. This integrated and commendable approach developed from a challenging debate on accountability for setting quality standards and the implications for consumer bills, promoted by the original water regulator, Sir Ian Byatt.²⁰ His concern was whether ministers properly applied the cost-benefit test in making decisions, and took accountability for it. "... I thought it was important to start a proper debate on what I called the cost of quality where I would say 'this is what quality might cost'... Then I said: 'Of course the people who are making the decisions on the quality are the ministers so please will the ministers take notice of this and that I am making the decisions on financing of functions. So whatever the ministers decide then I will finance the functions'. I would sometimes do this in what I regard as a relatively challenging way, 'Are you sure you really want to spend the money in this way?' I would have liked to have been able to challenge the European Union rather more than I was able to do".²¹
39. The key development, therefore, was to formalise the interrelationships, and hence the accountabilities, within the regulatory framework as a whole. It showed how the regulatory framework can evolve, and particularly where regulators, being independent, thereby have the opportunity to identify and raise a problem and achieve a change in the relationship; a contribution which was noted by Sir Christopher Foster: "What Ian Byatt did in the circumstances was as good as could be expected because, at least to some extent, he institutionalised the conflicting forces".²²
40. The consequence of this unbundling of the regulatory state has been to sharpen the accountabilities of specific regulators, Ministers and Parliament in relation to their respective roles and responsibilities, emphasising the interconnectedness of the various parties within the regulatory framework as a whole. If regulators are independent for a particular purpose, they nevertheless still fall within the overall responsibility of Government and Parliament for the regulatory system. It is independence within Government,

²⁰ The Cost of Quality: A Strategic Assessment of the Prospects for Future Water Bills (Birmingham: Ofwat, 1992).

²¹ Q14, Vol.II p6

²² Q209, Vol.II p73

rather than independence of Government *per se*. The Minister of State at the DTI, Mr Stephen Timms MP, captured this when he said: “Inevitably there is an impact by regulators on a range of government concerns. I do not think the regulators exist in a vacuum outside government policy. Inevitably the decisions of regulators do impinge on government policy; there is no point trying to pretend that is not the case, it clearly is the case. The best way to handle it is for government to be explicit about what it is looking for from the regulators in those respects and for the regulators to make their decisions in that context”.²³

41. One consequence of this, as we have seen earlier from Sir Ian Byatt’s evidence, is the increasing formalisation of the relationships within the regulatory framework, constraining or empowering the parties, one in relation to the other, as appropriate. The development of ministerial guidance has been referred to as a case in point in written evidence by the DTI: “In addition the Utilities Review 1998 led to the establishment of an additional process through which regulatory objectives may reflect government policy objectives. The review led to subsequent legislation introducing a duty on the energy and postal regulators to have regard to governmental guidance on social and environmental objectives ... similarly water in the water bill”.²⁴
42. In practice, our Inquiry has concentrated on the independent economic regulators. The scope of activities of these regulators encompasses both regulatory and non-regulatory activities and their independence from Ministers brings with it additional important considerations for accountability. In any event, environmental regulation and advice to Ministers is an important aspect of utilities’ economic regulation in practice, and social regulation has also played an important part in the debate on regulatory accountability and the role of ministerial guidance.
43. Evidence and requirements related to the effective accountability of these independent regulators therefore provides a model for the accountability of regulators generally.

²³ Q1097, Vol.II p392

²⁴ Vol.II p373

CHAPTER 3: ACCOUNTABILITY TO WHOM?

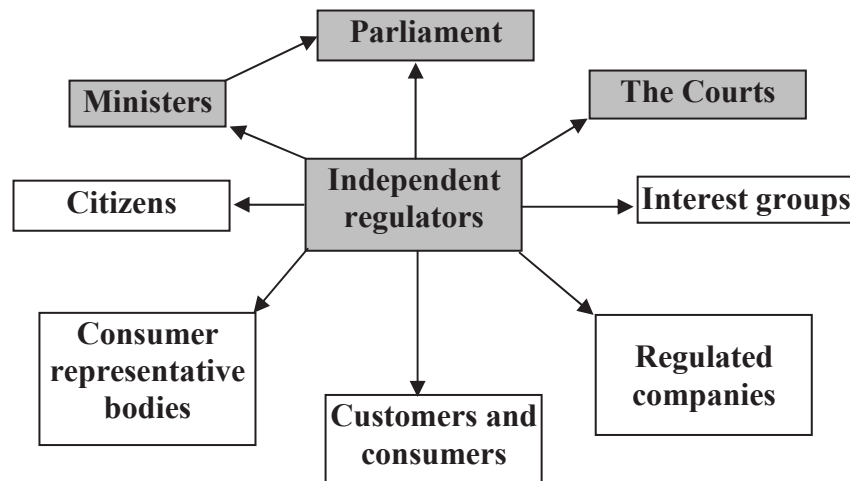
44. Before turning our attention to the processes for achieving effective accountability, we examine accountability to whom. This is because the three elements of accountability we set out in the next chapter are generic categories about the process, procedures and stages of accountability, but in their application they may vary in their incidence, and the balance between them, depending on who (or which group) the regulator is being accountable to. We start with the general view that regulators carrying out public functions wield considerable powers and must accept that these powers carry responsibilities, including the duty to explain to all interested parties, whether they are parliamentary select committees, Ministers, regulated companies, consumers or citizens. We recognise that this duty is likely to be exercised in different ways, and to different extents, for the different interested parties. It will depend on statutory and formal requirements, good practice, and an understanding of the information needs of each party. As Sir Derek Morris has said (see paragraph 74) the duty to explain is summed up for our purposes by the word “transparency”.
45. Equally, the rights of the various interested parties to expose the regulator to scrutiny will vary. Parliamentary select committees have a right to summon regulators to appear before them; this is a right not normally available to the individual citizen. Differences in such rights are clearly appropriate, whilst ensuring at the minimum level that all citizens (or their representatives) have sufficient access to information to enable them to question the regulator where there is a legitimate interest. Regulatory openness, whether through replying to citizens’ letters, or by holding the occasional public meeting (perhaps related to the publication of the annual report), ensures that exposure to scrutiny is available, in one way or another, to all.
46. Access to the possibility of judicial review may also be reserved to particular interested parties, although the ambit of that access is changing, and becoming wider. The range of issues which may be covered is also developing so that formal review might be extended to a challenge, not just on points of law, but on the substance of regulatory decisions.
47. In this regard, accountability of regulators to the courts should be seen not so much as a direct line of accountability, but as a means by which the direct end of accountability to affected, or aggrieved, parties is achieved. This view is qualified, of course, where the courts have the direct role of a primary regulator, rather than being the guardian for others against arbitrary regulatory decisions and activities.

The 360° view of accountability

48. Our view, therefore, is that accountability is a generic term, the precise definition of which depends on the circumstances, including the relationship between the interested party to the regulator. In practice, there are multiple accountabilities. For example, while regulated utility companies should be accountable to regulators for the proper performance of tasks assigned to them in their licence, in turn - and equally - the regulator should be accountable to them for the proper performance of the regulatory task. It should thus be possible for the companies to challenge the regulator, and for the regulator to challenge the companies, where one of the parties is not

properly carrying out its duties. This 360° view of the multiple accountabilities of regulators is illustrated in Figure 1.

FIGURE 1
360° view of accountability



49. This broad view of accountability is borne out by the evidence we have received. Baroness Young of Old Scone, Chief Executive of the Environment Agency, noted the Agency's vision of comprehensive accountability, qualified perhaps by a recognition of the practical problems that this can bring: "In fact we regard ourselves almost as accountable to everybody, sometimes too many people".²⁵ Lord Currie, Chairman of Ofcom, noted that its broad accountability reflected its statutory responsibilities: "...Ofcom is statutorily responsible both to individual members of the public, both in their capacity as *homo economicus* and as *homo civicus*, as well as to the public at large".²⁶ The Association of Independent Financial Advisers told us "but the regulator also needs to feel in some way accountable to those affected by its decisions. These will include consumers as well as the businesses which it regulates."²⁷
50. Tom Winsor, the Rail Regulator, drew our attention to the fact that the broad scope of accountability which attends independent regulation has also had the effect of intensifying that accountability: "Although Parliament has created independent regulators in privatised industries and in other fields of activity and enterprise to protect the public interest and in some respects to take the place of Ministers' general powers of direction over the boards of nationalised corporations, it has also created a matrix of accountability which is probably more specific and more intense than ever applied to a Minister. Perhaps that intensity was seen as necessary to take the place of the Minister's direct accountability to Parliament and the rest of the political process. However that may be, I believe it works well. That accountability, the accountability of the regulators, is to the executive, to Parliament, in some respects to a higher tribunal and, perhaps most importantly, to the people and organisations who use, finance or depend on the activities which we regulate ... I think that is a formidable array of accountabilities; I do not

²⁵ Q970, Vol.II p343

²⁶ Vol.II pp420-1, para 10.1.

²⁷ Vol.II p266

say that list could not be improved but I do say that the commentators who say we are unaccountable and that something must be done about us are wrong in law, are wrong in fact, and are wrong in policy terms”.²⁸

51. The 360° view of accountability therefore provides a context and reasons for improving the accountability of regulators.
52. However, we draw a distinction between regulators exercising a duty to explain – extending to all the bodies identified in Figure 1 – and being required to respond to demands made by those who gave them their powers or control the legal application of their powers. Citizens, consumer bodies and regulated bodies lack the power to summon regulators to justify their actions. We have reflected this distinction in Figure 1. The shaded boxes comprise the bodies that exercise power directly in relation to the regulators. These are the bodies that, as we shall see, are responsible for scrutiny and formal review. Ministers determine public policy and appoint the regulators. The courts interpret and apply the law passed by Parliament. Parliament is at the apex in that it passes the law creating the regulatory bodies and is the body responsible for calling Government to account. Parliament is thus fundamental to achieving an efficient and accountable regulatory regime. A traditional view of this line of accountability is set out in Appendix 4.

Accountability as a control mechanism

53. The processes of accountability, given effect through the three elements of accountability (duty to explain, exposure to scrutiny and the possibility of independent review) are an integral part of the macro design of the regulatory system as a whole. In effect, accountability is a control mechanism through which effective regulation is maintained (and endorsed), and failing or ineffective regulation is identified and exposed, and thereby subject to remedy and improvement.
54. The purpose of accountability is to provide a system of control which helps Government achieve efficient and effective regulation. This is both positive (facilitating) and negative (constraining), and in time, both pre- and post-event. This is illustrated in Table 1.
55. The ends of regulation can therefore be combined with discussion of the means of achieving it, one element of which is the systems control element of accountability. Accountability of regulators is therefore a means to an end – effective regulation – and not an end in itself.
56. The relationships of good regulatory design, accountability as a control mechanism through the three procedural elements, and accountability for what, to whom, is set out in summary in the Table 2.

The circle of accountability

57. Who does what and why has therefore to take account of both a regulatory system and a regulatory process over time, starting with Parliament setting the statutory framework and ending with Parliament reviewing regulation in practice. This is illustrated in Figure 2.

²⁸ Q 597, Vol.II p219

Independent consumer bodies

58. Independent consumer bodies have been established in recent years as part of the Government's policy of strengthening the consumer's voice in regulation and to challenge the regulators.²⁹ They include Postwatch, Energywatch and WaterVoice. They arose from a concern that regulators, in balancing the interests of the regulated companies (and their investors) with the consumers, might hear more of the company voice and have too great a regard for their interests (albeit that there were statutory consumer committees within each utility regulator's office).
59. The policy concerns the design of the regulatory framework, and should be judged by whether or not it improves the effectiveness of regulation, and is cost-effective. Proper accountability will enable that debate to take place, and judgements to be drawn. Our primary interest, however, is with two aspects of this accountability. First, that the independent consumer bodies should be equally held accountable, as are the regulators, for their activities, given they are part of the overall design of the regulatory framework. Secondly, with the apparent policy contradiction of both the regulators and the independent consumer bodies presenting themselves as consumer champions, particularly since it is the policy of the Government to place a primary duty of consumer protection on the independent economic regulators. But we are also concerned that cost-effectiveness, clarity of roles and public understanding might be undermined, thereby damaging effective accountability. While some tension is inevitable – even desirable – there is however also a risk of damaging public confidence in regulation if relationships become adversarial, especially since both parties have been appointed by Government to carry out consumer representative functions.
60. The case for independent consumer bodies was recognised by some regulators ahead of statutory provision for their appointment. Though appointed to take into account the interests of consumers, regulators were not necessarily able to know clearly and consistently what those interests were. It was thus useful to have some input from a body representing consumers. To ensure a greater degree of independence, these bodies now exist outside rather than within the offices of the regulators.

TABLE 1
Elements of the accountability 'control system'

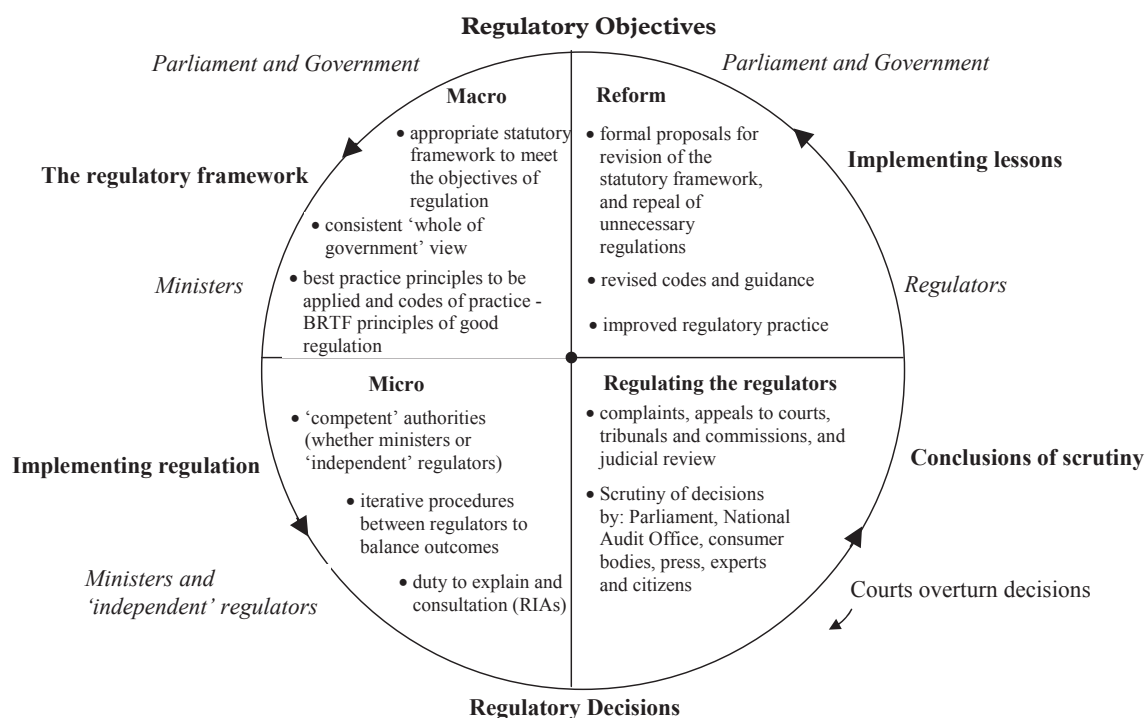
	<i>Prospective</i>	<i>Retrospective</i>
<i>Positive (carrots)</i>	harnessing the means of accountability to facilitate good regulatory decision-making, and to avoid the pitfalls of regulation	confidence building from either good regulatory outcomes, or learning from past failures and problems, allowing the beneficial evolution of the regulatory system
<i>Negative (sticks)</i>	the discipline on regulators of the threat of exposure by accountability mechanisms (avoided by good regulatory decision-making)	attributing fair blame for poor regulatory decisions (with penalties or redress as appropriate), with the incentive to avoid such blame in the future.

²⁹ See in particular government's review of utility regulation: *A Fair Deal for Consumers - Modernising the Framework of Utility Regulation* (London: Department of Trade & Industry, March 1998); and *Consumer Councils: The Response to the Consultation* (London: Department of Trade & Industry, April 1999).

TABLE 2
Effective regulation depends on

<i>Good regulatory design</i>	<i>Control through the processes of accountability</i>	<i>Accountability for outcomes: regulatory performance</i>
<p>Macro (policy) The whole of government view: - encompassed in the regulatory (legal) framework of functions, powers and duties: the division of roles and responsibilities - whether by regulatory sector, theme or hierarchy e.g. arms-length independence versus direct ministerial regulation</p> <p>micro (implementation) 'Competent' authorities</p>	<p>Duty to explain (provision of information and reasons for decisions)</p> <p>exposure to scrutiny (use of information - answerability and challenge)</p> <p>the possibility of independent review (complaints, appeals and judicial review - particularly in respect of conformance rather than performance)</p>	<p>Accountability to whom: Citizens Parliament Government Ministers Departments of State Regulators Customers Consumers Regulated companies Other interested parties.</p>

FIGURE 2
The circle of accountability through the regulatory cycle



61. However, to what extent can the consumer bodies claim to be representative of consumers? They are not chosen directly by consumers but instead are appointed by the regulator or a minister. In their evidence to us, the officers of the different bodies explained the extent to which they relied on open meetings and surveys of consumers. Ms Deirdre Hutton, Chair of the National Consumer Council, told us that the NCC "did not represent

consumers, we are not a democratic body and representation of consumers in that sense is for those who are democratically elected”. She then told us that “what we endeavour to do through qualitative and quantitative research and through policy analysis is to understand what the interests of consumers are”, finally observing that “since everything we say is public, people soon let us know if they disagree”. The NCC, which does not exist to cover a particular regulator, stands in a distinct position. Ms Hutton told us that the NCC does not represent consumers. Even so, when asked how she knew whether the Council was accountable, replied: “We do a lot of consultation”.³⁰

62. The Consumers’ Association told us that it is “an independent, not-for-profit consumer organisation that is entirely independent of government and industry”, and that it has “worked on behalf of consumers to achieve improvements in the quality and standards of goods and services for more than 40 years”.³¹
63. Maurice Terry, the Chairman of WaterVoice, told us that openness was their way of being accessible, so that “all our committee meetings are held in public, and some of our regional committees have listening sessions, where they invite members of the public to contribute”.³²
64. The work of the independent consumer bodies in seeking to ensure that they can claim to speak authoritatively for the consumer is commendable. However, we are struck by the fact that each body is left to decide for itself what is the most appropriate mechanism for discerning the interests of consumers. There appears to be no common framework. In its response to the Better Regulation Task Force’s report on independent regulators, the Government said that it “wholeheartedly agrees that there is scope for improving the performance of ‘the rest’ to bring them closer to ‘the best’”.³³ The same point we believe is appropriate in the context of the consumer bodies.
65. We were also concerned by the fact that engaging in surveys can be a significant drain on resources. The bodies are not generously resourced – they are small units, especially relative to the offices of the regulators – and are constrained in undertaking the type of consultation that they think is necessary. We believe that both problems must be addressed. There needs to be greater consistency in approach. There is little point in creating a consumer body that can match the resources of the regulator, but we recognise that consumer bodies need adequate funding.³⁴
66. On our second area of concern – the clarity of the relationship between consumer bodies and the regulators – we found that the potential for conflict between bodies claiming to promote the interests of consumers was variously fulfilled. The evidence presented to us suggests that relationships can be troublesome. We were struck by the poor relationship that exists between Postcomm and Postwatch. Postwatch was critical of the lack of co-operation on the part of Postcomm, believing that it failed to be as transparent as it

³⁰Q1053, Vol.II pp364-5

³¹ Vol.III p41

³² Q344, Vol.II p121

³³ Ministerial Written Statement, Cabinet Office, Government’s Response to Better Regulation Task Force Report: “Independent Regulators”, 9 Feb. 2004.

³⁴ It should be noted however that according to *The Daily Telegraph* of 16 March 2004, quoting a report by the European Policy forum, consumer bodies in some cases employ more staff than the regulators.

should be in its dealings with Postwatch.³⁵ Postcomm considered that Postwatch was ill informed in its approach.³⁶ The extent of the poor relationship was noted by the chief executive of Royal Mail: “I think Postwatch’s position is quite clear. They believe that there should only be one regulator and it should be Postwatch. The fact that we have two bodies which have some overlapping duties towards consumers has resulted in, from our perception, the two bodies almost trying to outdo each other in their degree of toughness in standing up to each other and ourselves, which I think has damaged our relationship with both of them. I have always thought it far more likely that one of our regulators would judicially review the other before we would ever judicially review either of them. I think it has been a recipe for disaster”.³⁷

67. The Electricity Association was equally concerned with respect to Energywatch.³⁸ Clare Spottiswoode also noted the inherent tensions;³⁹ Professor Littlechild drew attention to how difficult it was to reconcile the giving of a primary duty of consumer protection to the regulators “with the simultaneous creation of an independent consumer body whose duty is also to promote the interests of consumers”.⁴⁰
68. Poor relationships are not constant features. Ofcom, which has been established with a consumer panel, as with the FSA, appeared to have no concern about the independence of its operations.⁴¹ Relations thus differ from sector to sector. This may reflect the personnel involved or it may reflect the different methods of appointment and structures created for each sector. The existence of poor relationships, at times verging on the adversarial, is clearly undesirable and needs addressing. A robust relationship need not necessarily equate to a poor relationship. Ms Hutton of the NCC told us that the Council had achieved change through criticising Government where necessary: “In general terms, governments of all colours have appreciated that the value of the National Consumer Council to them lies in its independence and its robustness of thought”.⁴² A similar relationship between independent consumer bodies and the regulators is desirable.
69. **In order to address the problems we have identified, we recommend that independent consumer bodies be obliged by statute to engage in open meetings and conduct regular surveys of consumers. This has resource implications which should be met out of public funds. Following a review of the budgetary arrangements for each regulator an appropriate formula should be agreed for calculating this provision and applied to each of these bodies. We believe that these changes will enhance both the accountability and the independence of the consumer bodies.**

³⁵ Q394, Vol.II p193

³⁶ Vol.II p238, para 10

³⁷ Q648, Vol.II p235

³⁸ QQ521 & 523, Vol.II p 175

³⁹ Vol.II p140, para 45

⁴⁰ Vol.II p23

⁴¹ Vol.II p420, para 8.2

⁴² Q1081, Vol.II p370

70. **We are aware that the Government is undertaking a review of consumer bodies, supported by the National Audit Office (NAO), and recommend that the review includes an examination of the relationship between regulators and the related consumer bodies in order to introduce greater clarity in the relationship, if necessary through a statutory provision common to the regulatory regime.**

CHAPTER 4: EVIDENCE OF CONCERNS – ACCOUNTABILITY IN PRACTICE

71. Having considered accountability for what, and to whom, the next question is how that accountability is given effect in practice, and what role it can play in achieving effective outcomes from regulation. The purpose of accountability of regulators is to help secure both the effective design of the regulatory system as a whole and the effective operation of the regulatory system in its constituent parts. Effective regulation requires effective accountability. If the control mechanism of accountability fails, then effective regulation is endangered, risking arbitrary exercise of regulatory power, inequity and loss of confidence in the regulatory system. Each of the three elements of accountability has to work well in this respect, and should be critically examined in respect of the part that it plays. We have received evidence of concerns in all three areas.
72. The Committee received evidence on a number of definitions and interpretations of accountability, and it is clear that differences here affect the judgement on how effective the accountability of regulators is, or could be. The DTI's written evidence listed the mechanisms, rather than defining accountability: "Regulators' actions are subject to the following accountability mechanisms: Appeals processes; parliamentary scrutiny; Consumer representation; and transparency".⁴³ The Minister's oral evidence repeated these, and added in corporate governance, notably with reference to the new board structures for independent regulators, as a further mechanism.⁴⁴
73. The Committee therefore considered the elements of the accountability process which make or break the achievement of effective accountability, elements which have been the subject of much concern in the evidence we have received.
74. The elements of accountability, which were persuasively set out in Sir Derek Morris's evidence, distinguish three stages in the processes of accountability, all three of which play an essential part in achieving not only effective accountability, but any proper accountability at all: "... I do think that there are three different and equally important levels of accountability. The first, to give it an epithet, would be transparency. People have to know what you are doing and how you have done it, and in trying to explain that and in being forced to explain there is an element of accountability ... The second is more penetrating. It is not just transparency. It is actually being questioned, if you like grilled, on what you have done and how effective have you been in doing it. The decisions cannot be changed but you can be cross-questioned. There, fairly obviously, the role of the select committees is paramount. The third level is where, of course, the decisions can be changed, and that is in our case through judicial review and to the High Court".⁴⁵
75. The elements of accountability can be summarised as:
 - the duty to explain

⁴³ Vol.II p375, para 27

⁴⁴ Q1087, Vol.II p390

⁴⁵ Q901, Vol.II p 320

- exposure to scrutiny, and
- the possibility of independent review.

All three have to be effective if there is to be due accountability of regulators overall, and for the regulators to be challenged where appropriate and held answerable for their actions.

The duty to explain

76. The first element of the accountability process relates to the obligation on the regulator to provide information on its activities and, in particular, to explain the basis of decisions. This includes not only the decision itself, but also the thinking used to lead up to the decision, and the thinking as to why the particular decision (or regulatory instrument) was chosen, as compared with other alternatives available. The technical level, means used (media and fora), and extent of information provided (summaries or full texts) might vary between different interested parties, but we accept that the regulators have a general duty of accountability, characterised by openness or transparency in this regard, an obligation to provide information to all interested parties (or stakeholders), tailored to their locus in the regulatory scheme and the accountability procedures appropriate to that.
77. The general presumption of openness might be qualified, in particular where information available to regulators concerns personal details, or commercial confidentiality is required. Past Monopolies and Mergers Commission reports have often contained large sections of excised data, which on occasion have rendered the arguments and basis for the decisions inaccessible. We have heard from Sir Derek Morris that whilst commercial confidentiality clearly still remains an issue for the Competition Commission, he hoped that future drafting of documents would be such that the essential basis of arguments for decisions would be evident. This was the Commission's declared intention: "We tended to err on the side of protecting confidentiality and I do believe there have been some reports in the past that I will not say were incoherent but were beginning to get a little difficult to understand because of those excisions, and that is a public detriment ... (but post Enterprise Act 2002) I think that means there is going to have to be more disclosure and there will be more cases in which the tension that you have described leads to some commercially sensitive material having to appear in order that the decision can be explicable".⁴⁶ Accountability in relation to regulatory excisions of published information suggests that there should be some form of independent scrutiny, with a published confirmation of the appropriateness of the excisions.
78. A number of witnesses identified areas where progress has been made in improving accountability, especially in terms of openness. However, we have also received evidence that the regulators:
 - provide insufficient information and do not give full reasons for decisions;
 - provide too much unstructured information, which undermines the ability of interested parties to challenge them.

⁴⁶ Q904, Vol.II p321

79. We have received a large volume of evidence concerning financial services regulation, particularly from Independent Financial Advisers (IFAs). Most submissions claimed that the FSA's bureaucracy is excessive, and state in general terms that the FSA is high-handed and insufficiently accountable. There were complaints about the retrospective application of rules, which raises concerns about inequitable treatment and the cost of professional indemnity insurance. We note in particular the complaints about excessive consultation and consultation on non-essential issues.
80. The evidence indicates that the burden of regulation generally is of great concern.⁴⁷ There is a clear requirement for regulators to explain their actions, so that the cost of regulation can be properly judged against the public benefits from regulation. The Electricity Association told us that: "It seems wholly inappropriate, for example, that Ofgem is under no legal duty to publish annual accounts, and that its service delivery agreement with the Treasury says nothing about the desirability of reducing the real costs of regulation."⁴⁸ The consumer watchdogs were equally concerned".⁴⁹
81. The UK mobile operators told us that the regulator should be "justifying why he needs sector specific economic regulation ... particularly where in the mobile sector we do not come from a monopoly background".⁵⁰ Northumbrian Water's view was that "If there is concern that regulators should become more accountable, then clarifying their objectives would be a good start".⁵¹ We were also informed that "Ofgem does not provide reliable information on its key activities where its prestige is on the line; it not infrequently self-promotes itself and spins. Consequently it is not effectively self-accountable. I recommend that when Ofgem reports the success or otherwise of its activities, the reports are reviewed by an independent external party appointed by the NAO".⁵²

Exposure to scrutiny

82. Our conclusion of a general duty to explain leads onto the second element of accountability, which is exposure to scrutiny; the requirement to answer questions and to provide the means through which that scrutiny can be made meaningful. In this sense, effective scrutiny is seen as a countervailing force to the power of the regulators, in that the process of scrutiny has the real power to improve outcomes, either in the short or longer term. It can take the form of consultation, where response is invited from stakeholders, or a process of inquiry initiated by a body other than the regulator. The latter may encompass requests for information from regulated bodies or a formal requirement to answer questions by a parliamentary committee.
83. The avenues by which regulators can be and are scrutinised include those shown in Table 3.

⁴⁷ Q826, Vol.II p287 (see also Q 851, Vol.II p291)

⁴⁸ Vol.II p163, para 12

⁴⁹ Vol.II pp148-9; Vol.II p129

⁵⁰ Q1177, Vol.II p439

⁵¹ Vol.III p131, para 49 (see also para 50)

⁵² Vol.III p90, para 24

TABLE 3

Avenues of scrutiny

<p>Parliamentary scrutiny - whether by debates in either House, or by select committees of either House, or by joint committees of both Houses;</p> <p>Ministerial meetings with regulators - where there might be part of a regular cycle or occasioned by specific issues as they arise. This scrutiny is accompanied by the longer term power in the hands of the Minister, which is not to reappoint the regulator;</p> <p>Responses to regulators' consultation documents, including participation in fora set up by the regulators to engage interested parties in the debate, including working groups, seminars and open meetings;</p> <p>Specific requests to the regulator from interested parties, whether, for example, from regulated companies, consumers or investors, and covering complaints about a regulator's activities as well as other matters;</p> <p>Scrutiny by representative bodies and interest groups, for example, consumer bodies, both national (such as the National Consumer Council (NCC) and the Consumers Association (CA)) and sectoral (such as Energywatch, Postwatch or WaterVoice), as well as interest groups or NGOs, such as Friends of the Earth;</p> <p>Press scrutiny;</p> <p>Academic and other expert commentators, such as policy institutes;</p> <p>Formal reporting occasions, such as open meetings conducted to launch the annual report of the regulator or to carry out an educative purpose to widen knowledge of the regulator's functions, mission and approach.</p>

84. We have received evidence that:

- some regulators do not consult interested parties to exchange views. There may be insufficient time for consultation, inadequate fora, or it is perceived that the consultation is simply one of form, since the decision has already been taken;
- Parliamentary select committees have not shown sufficient consistency, continuity or expertise to give full effect to their important position in the process of achieving effective accountability. The Electricity Association was particularly concerned, given the broad discretionary nature of the statutory framework for utility regulation. Their resulting conclusion: "the EA believes that the weak political accountability of regulators needs to be counter-balanced by a more effective framework of legal accountability".⁵³ This is an important concern, to which we shall return in later chapters.

85. As to the effectiveness of consultation, the Electricity Association was rather damning of Ofgem's record: "it would also be incorrect to say that Ofgem's consultations are particularly effective, either for the public or for licensees. With only rare exceptions, the procedures do not achieve what the courts have defined as the essence of consultation, namely the extending by a public authority, with an open and receptive mind, of an invitation to other parties to provide advice about its proposals at a formative stage, before its mind has set".⁵⁴

86. The consumer watchdogs were equally concerned. Energywatch was dissatisfied with both the consultation - "there is considerable scope for improving the Ofgem consultation process through the provision of cost-benefit analysis and consumer impact assessments"⁵⁵ - and the response that they receive - "Quite frankly, I have not always been satisfied with the

⁵³ Vol.II p163, para 7

⁵⁴ Vol.II p167, para 42

⁵⁵ Vol.II p149

responses I have had. Sometimes I have had no response”.⁵⁶ Postwatch was similarly critical stating that “Postcomm does not give its views or those of other consumers adequate consideration”.⁵⁷

87. However, we received warnings that the extent of scrutiny itself has to be subjected to a cost-benefit test. Postcomm told us that they “think it adds up to a pretty formidable stack of reporting back and information ... there comes a point at which the degree of oversight and the number of bodies, if you add on the National Audit Office, the Better Regulation Task Force and so on, become self-defeating. I think it would be impertinent for us to judge whether we are at that point now or not. We have obviously complied with whatever obligations it is decided to put on us, but we feel we spend quite a lot of time explaining ourselves at the moment”.⁵⁸

Independent review

88. Scrutiny has the power to affect regulatory outcomes. However, it is indirect, and has to be complemented by the third element of the accountability process, which is the possibility of independent review, whereby regulatory decisions may be formally overturned or varied.
89. Independent review encompasses judicial review and a statutory appeals process. Regulators are bound by statute and must abide by any secondary legislation derived from it. They are also subject to ministerial guidance, where this is authorised by legislation. They are also bound by European Union law and, as a consequence of the Human Rights Act 1998, must exercise their powers in a manner consistent with the rights protected by the European Convention on Human Rights.
90. Regulators must also observe the principles of administrative law and must not act irrationally: that is, they must not make a decision that no reasonable regulator could have made. Therefore, in the absence of any other remedy provided by Parliament, those who are adversely affected by a regulator’s decision can, if they believe the decision infringes their rights under administrative law, apply to the Administrative Court for judicial review. Judicial review is available as a residual remedy for enforcing the legal duty of regulators.
91. Unlike judicial review, which is always available as a residual remedy, a right of appeal exists against a regulatory decision only when Parliament has provided for this. Legislation is needed not only to create the right to appeal but also to establish the body to hear it, the nature of the process and the grounds on which an appeal may be brought.
92. On judicial review, there is some international consensus. The OECD summed it up thus: “the availability of judicial review of administrative decisions can be seen as the ultimate guarantor of transparency and accountability and is likely to improve the effective quality of the decisions made during administrative review”.⁵⁹ Clearly judicial review is seen as a feature of effective accountability although it is, by its nature, essentially

⁵⁶Q493, Vol.II p159

⁵⁷ Vol.II p130, paras 17-21

⁵⁸ Q695, Vol.II, p250

⁵⁹ Regulatory Policies in OECD Countries - From Interventionism to Regulatory Governance, p. 75: OECD Reviews of Regulatory Reform (Paris: OECD, 2002).

negative and narrow. The availability of pursuing such action is important in regulation, given that a regulator both advances the case and makes the decision and, as Professor Prosser described it, is seen as “acting as prosecutor and jury on an issue”.⁶⁰

93. The value of an appeals system is generally agreed. Sir Christopher Bellamy, Chairman of the Competition Appeal Tribunal, referred us to three important features of an appeals system: “First of all, the scrutiny of the appeals system or perhaps even just the existence of an appeals system should improve the quality of decision making and I have the subjective impression that that has happened. Secondly, the existence of a system and its operation should increase confidence in the system as a whole ... Thirdly, it is a safeguard against regulatory capture, regulatory inertia or regulatory timidity which with the best will in the world may creep into any regulatory system from time to time”.⁶¹
94. However, we have heard much evidence that traditional judicial review has not provided an effective protection, based as it is on *ultra vires* and a restricted definition of reasonableness. We have received evidence that whilst judicial review is seen as important in the context of challenging regulatory decisions, it has little role to play in challenging the merits of decisions.
95. British Energy told us that: “Judicial review to us is a sledgehammer, it creates an uphill struggle on the part of the regulated body to prove that the regulator was completely unreasonable or stark raving mad, it makes it a difficult process coming from the regulated body. If one goes back to the human rights legislation, the basic principle is that there should be some sort of appeal on the merits, rather than whether it was totally unreasonable”.⁶² The Electricity Association concurred.⁶³
96. The consumer bodies were concerned that they had few appeal rights at all against a regulator who was overly favouring the regulated company.⁶⁴ They were particularly concerned if regulated companies should have their appeal rights improved from the current position, as this would further highlight the weakness of their own position.⁶⁵ However Postwatch did recognise that legal actions between two public bodies was not something to be encouraged.⁶⁶
97. Nevertheless, regulators have told us of how effective a discipline fear of judicial review is on their actions and decisions. The first telecoms regulator, Sir Bryan Carsberg, told us that: “No regulator wants to have decisions overturned through judicial review. It seemed a matter of good management and prudent behaviour to consider the danger and to take steps to avoid it”.⁶⁷ Professor Stephen Littlechild, the first electricity regulator, also questioned the idea that judicial review is an ineffective remedy: “I was judicially reviewed three or four times.... I won some and I lost some. Again it was a

⁶⁰ Vol.II p52

⁶¹ Q1032, Vol.II p358

⁶² Q256, Vol.II p96

⁶³ Vol.II p165, paras 26 and 29

⁶⁴ Vol.II p129, para 11

⁶⁵ Q1065, Vol.II p367

⁶⁶ Q395, Vol.II p133

⁶⁷ Q195, Vol.II p 68

very thorough investigation. I think what this means is that anybody potentially adversely affected has a real, practical possibility of challenging what the regulator does, and there is evidence that parties have challenged and have won”.⁶⁸

98. We have also heard evidence that the position is changing. The development of human rights legislation is having a general impact on both the ambit of protection to aggrieved parties afforded by judicial review generally, as well as having affected the statutory position in recent legislation whereby, for example, the Communications Act 2003 incorporated a European Directive which allows appeals to an independent tribunal, and appeals on the merits of the case.⁶⁹ We have been told that this can be traced to Article 6 of the European Convention on Human Rights.⁷⁰ We have also been told that there has been a judicial reinterpretation in relation to the substance of appeals, which is being welcomed by Parliament: “There is also a move by Parliament to increase the scrutiny by the court or tribunal of the merits of the decision. The origin for this is found in the Competition Act 1998 under which the Office of Fair Trading and the sector specific regulators in their own areas are subject to an appeal broadly on the merits to a body now known as the Competition Commission Appeals Tribunal. The origin of that is that the Court of First Instance in Luxembourg, which hears appeals from the European Commission, has adopted a set of procedures which is closer to an appeal on the merits or a re-hearing than just judicial review”.⁷¹
99. But we note that the evidence of concern can also be about not extending the right of appeal too far such that it could distort the public purposes of good regulation. Ofgem noted that “all of Ofgem’s decisions are subject to some form of appeal... Ofgem believes that very careful consideration needs to be given to any proposal for change ...”.⁷² Philip Fletcher, the water regulator, was concerned that companies should not have the opportunity through more extensive appeal mechanisms to ‘salami-slice’ issues in decisions which were essentially an overall package.⁷³ The DTI told us that “it is not obvious that a change in the current system is necessary, or even desirable”.⁷⁴
100. If there are those who are concerned that increasing the rights of the regulated to appeal decisions might create game-playing to undermine effective public regulation, we note two countervailing influences. The Competition Appeal Tribunal has told us that the right of appeal is balanced by the right of the Tribunal to be able to strike out appeals for which there is no proper case.⁷⁵ Also, we have been told that where further rights of appeal against regulators’ decisions are granted to regulated companies, then consideration should also be given to extending the rights of appeal by consumers and other interested parties against the decisions of regulators, who are meant to be protecting their interests.⁷⁶ The regulated companies

⁶⁸ Q83, Vol.II p29

⁶⁹ Vol.II p418, para 5.2

⁷⁰ Vol.II p52

⁷¹ Q121, Vol.II p46

⁷² Vol. II pp180-181, paras 20 and 23

⁷³ Q590, Vol.II p208

⁷⁴ Vol.II p376, para 34

⁷⁵ Vol.II p352, para 25

⁷⁶ Vol.II p363, para 38

accept the need for a balance, as we heard from Innogy plc: “An effective appeal process is a key element in promoting regulatory accountability. Such a process should provide an important incentive to regulators to ensure good decision-making, thus reducing uncertainty and promoting greater confidence in the regulatory framework. At the same time, it should also maintain a balance between stakeholders and filter out nuisance appeals”.⁷⁷

⁷⁷ Vol.III p104, para 5

CHAPTER 5: FACTORS WHICH CAN UNDERMINE EFFECTIVE REGULATION AND ACCOUNTABILITY

101. The evidence analysed in chapter 4 shows significant concerns in all three elements of accountability. There appear to be common causes for many of these concerns. This chapter groups these together, as a precursor to examining improvements which could be made to achieve better accountability. Effective accountability and regulation can be undermined by pitfalls, poor communication to, and poor understanding by, those to whom accountability is directed, and overall incoherence in the design of regulatory roles and responsibilities:

Pitfalls

- (a) presumption: regulators assume that they are there to do good and therefore have a view of what is good, which they may consider to be superior to the view of the regulated bodies. This weakens the presumption of their due accountability. Regulators can equally abuse their monopoly power, either by empire-building, imposing excessive requirements for information or regulations, or micro-management of the regulated business. Sir Bryan Carsberg told us that “There is a natural danger for regulators to over-regulate and try to solve all apparent problems...”.⁷⁸ The UK mobile operators set out the arguments as they saw them: “Of tel and others, such as Offer [Office of Electricity Regulation, now merged into Ofgem] and Postcomm, were formed as the overseers of the liberalisation of markets formerly controlled by state monopolies (perhaps they should have been called ‘liberators’ not regulators)”.⁷⁹ They then went on to say “A regulator was seen as a necessary catalyst to this transition - a means to an end not an end in itself”. They accepted that Of tel had been successful but had a caveat “Of tel scores reasonably on many of the topics of your inquiry. It demonstrates independence from Government and industry. It consults widely and is fairly transparent with its processes. But, after nearly twenty years in existence, it is no nearer withdrawing from sector specific economic regulation”.
- (b) conflicts of interest: such as where Government retains ownership and regulation, as with Royal Mail and Rail, or where the regulators’ desire to demonstrate effective independence (through demonstrably rational, disinterested regulatory decision-making) is compromised by the desire for reappointment, leading to capture by Government. One example of this danger might be an appeal by the regulated company appealing to the owner rather than the regulator for the solution to their perceived problems if they feel under too great a pressure. Postwatch was particularly concerned because “The role of the DTI in postal regulation is to say the least complex. The Department appoints the commissioners of Postcomm, the councillors of Postwatch and the chairman of the Royal Mail group ... The interests of the Royal Mail Group, the UK postal industry

⁷⁸ Vol.II p61, reply to q4.

⁷⁹ Vol.II p434, paras 2.3, 3.2, 3.3

and postal users are not always (if ever) the same. It is unclear how much weight DTI gives to each interest group when reaching its decisions; conflicts of interest inevitably arise”.⁸⁰ Postcomm echoed that concern, noting that, because of this, the respective roles of the Secretary of State and Postcomm had to be clearly understood and respected.⁸¹ Postcomm drew our attention to one case of a proposed merger between Royal Mail and TNT where Postcomm had to stand their ground against the Government’s shareholder interest, concluding: “In the end it did not go ahead. I think we drew a line with a firmness which will not be forgotten, which did not involve actual hostility”.⁸²

- (c) paternalism: second-guessing consumer interests. Regulators may seek to act benignly, acting in what they see as the best interests of the regulated, without necessarily consulting in order to determine whether they are correct in their assumptions.
- (d) inconsistency over time: notable in cost-benefit tests – involving assessments of probability – for regulatory decisions, such as on security of supply and safety. This has been a notable issue in both water regulation, with respect to the setting of leakage standards following the 1996 drought, and rail regulation following the Paddington rail disaster, in particular relating to the Minister’s promised investment in train protection systems. So, for example, before an event a rational regulatory decision on the level of preventative maintenance could be made, but after the event the arguments on which accountability for the decision were based seem very different. Sir Howard Davies of the FSA told us that this had also been their experience in the public debate on Equitable Life.⁸³ Achieving consistency requires a sophisticated blend of leadership, objectivity, trust, continuity, and no-blame cultures.
- (e) change for change’s sake: more policies and reform are assumed to be better than less policies and continuity. This to some extent is a variation on the theme of presumption. Regulators may be prone to justify their existence by being over-active.
- (f) misplaced dignity: unreasonably protecting precedents or decisions which can be shown to be flawed for reasons of maintaining the authority and dignity of regulation, rather than promoting a learning culture which develops regulation in the light of experience, and consistent with its underlying purpose.
- (g) stereotyping: where this may lead to misinterpretation: for example, where profit is seen pejoratively, or an adversarial regulatory system is seen as flawed *per se*, rather than as a design feature for effective regulation.

⁸⁰ Vol.II p130, para 15

⁸¹ Vol.II p238, para 10

⁸² Q666, Vol.II p245

⁸³ Q869, Vol.II p305

Poor communication and understanding

- (a) lack of knowledge of the regulatory framework on the part of citizens and consumers weakens their ability to promote, or be engaged in, effective accountability. Sir Howard Davies described the implications of this, again in the context of Equitable Life: “...(the Parliamentary Ombudsman’s report on Equitable Life)...referred to what she saw as a mismatch of expectations in what the public, represented by some of the people who had complained to her, expected a prudential regulator could achieve and what prudential regulation was designed to achieve, and certainly it is quite difficult to explain that we are not even aiming for a non-zero failure regime, and we do not think it would be appropriate to aim for a non-zero failure regime because to do so would only constrain financial institutions and make it impossible for them to carry out the function of taking risk that we believe is essential to financial markets.... Explaining where you are drawing that line and where you are setting that level of protection is probably the biggest single challenge we face in gaining acceptance and understanding for the nature of regulation we seek to maintain, but setting that balance is inherent in the Act”.⁸⁴
- (b) lack of confidence/skill/opportunity in accessing regulatory information, participation processes or mechanisms of redress; stakeholders may not have a clear understanding of processes and how the regulator operates.
- (c) lack of trust leading to a misunderstanding of regulation.
- (d) the role of accountability as a control mechanism is misunderstood - a means rather than an end.
- (e) obfuscation of the regulatory mission, whether by design or default and particularly where this interfaces with separation of responsibilities, such as representing consumer interests.

Incoherence

- (f) inadequate separation between the three pillars of regulatory policy: economic, social and environmental. The NCC identified difficulties that can arise between Government and regulators where there is lack of clarity on respective roles. In particular they stated that “where there are social objectives in a sector, it can be unclear whose responsibility it is to set them and achieve them. Tackling fuel poverty, or extending access to financial advice, are current examples where the regulator has an important role”.⁸⁵
- (g) insufficient commitment to the ‘whole of Government’ approach to regulatory design and implementation (unnecessary duplication, overlap or proliferation of regulatory roles and institutions; inadequate central scrutiny and/or co-ordination of review roles; inadequate application of generic models of regulation, except where sectoral differences are objectively justified) - in effect - the

⁸⁴ Q868, Vol.II p304

⁸⁵ Vol.II p362, paras 23 and 24

guardianship of effective regulation through accountability is fragmented (see also paragraph 102 below)..

- (h) poor statutory design, such as excessive, or contradictory, lists of statutory duties placed on the regulators.
- (i) missing principles of good regulation: objectivity, rationality and coherence.
- (j) emphasis on internal board structures and accountabilities rather than external accountability of the function.

102. An example of insufficient commitment is the potential for erosion of effective accountability where regulatory structures become increasingly complex, and become disengaged from public understanding. Railways have presented us with a clear example. Rail regulation and its associated institutional structures is complex, and it seems that interested parties do not have a clear idea of who does what, and should be held accountable for what decisions. We can only observe the past and present debates on rail policy and performance, and the evidence that we have received. It underlines the danger that lack of clarity with respect to the regulatory framework will undermine regulatory accountability, and equally therefore, effective regulation. In referring to the distinctions between economic opportunities and social obligations, Sir Christopher Foster said “I hope Lord MacGregor will not mind my saying that I think, since his time, they have gone rather woefully wrong in relation to the railways. Everybody seems to be doing not the job for which they were set up but some other job”. With respect to the SRA he added “It is that kind of muddle which I honestly believe the regulators should be protected from. They are then becoming quasi-political figures, and I do not honestly believe that that is a sensible job for a regulator”.⁸⁶ In particular the problem arises over transparency of trade-offs by the regulatory body.⁸⁷ The evidence on confusion was reinforced by two of the Rail Regulators. Tom Winsor told us that “The distinction between the two bodies is frequently misunderstood”.⁸⁸ He was clear however that regulators did not necessarily take any responsibility for rail crashes.⁸⁹ John Swift QC noted that “There has always been a difficulty in the mind of the public, and not just of the public, in knowing the precise difference between the strategic rail authority or the franchising director, as it then was, and the Rail Regulator”.⁹⁰

103. The implications of these hazards or failings is that attention has to be paid to the effectiveness of accountability mechanisms to control the regulators, and to improving the context and awareness in which interested parties can play their role in achieving effective accountability. Remedies may be provided through different means. In our remaining chapters we make various recommendations designed to alleviate or eliminate impediments to effective regulation and accountability.

⁸⁶ Q208, Vol.II p73

⁸⁷ Q218, Vol.II p76

⁸⁸ Vol.II p211, para 4

⁸⁹ Vol.II p212, para 24

⁹⁰ Q115, Vol.II p46

CHAPTER 6: IMPROVING THE REGULATORY STRUCTURE – THE DEVELOPMENT OF BOARDS

104. The direction of Government policy in recent years has been to replace those regulators with powers vested in the individual (for example, the Director Generals covering the utility and network industries) with regulatory Authorities, comprising a board. The board is generally to be structured on lines consistent with the Code of Practice on Corporate Governance applying to companies: this includes the separation of the role of chairman and chief executive and the appointment of a majority of independent non-executive directors.⁹¹
105. We received considerable evidence on the reasons for the move from individual regulators to boards. The move in many respects mirrors practice in most companies, which have a Chairman, Board and Chief Executive Officer. The move has been generally welcomed,⁹² though there were caveats expressed by some who had served as individual regulators.⁹³ The argument for an individual regulator is that such an appointment enables the regulator to take the initiative and move quickly – not being held back by collective decision making – and to represent a clear and consistent face of regulation. A body such as a board may be slow and able to avoid some of the rigours of accountability faced by individual director generals.⁹⁴ The move towards boards has been motivated by the need to bring in a greater range of skills – even individual regulators variously appointed a body or board of experienced people to advise them – and to avoid the pitfalls that may occur from relying on the judgement of a single regulator.
106. The creation of boards also facilitates a more efficient use of resources, with a clear division between chairman and chief executive, rather than combining the responsibilities in a single post. The board structure also enables the burdens of regulation to be borne by several people, especially valuable in those sectors where the regulatory responsibility is broad and heavy, as for example with the newly created Ofcom framework.
107. Boards, like individual regulators, work within a clearly stipulated statutory framework. Experience has enabled that framework to be refined and enhanced. The requirement on a regulator to apply the principles of good regulation in their decision-making, and to be accountable for that, applies equally whether it is a board or an individual Director General. Sir Howard Davies told us in respect of the FSA that “any proposal [to the board] for a regulation or a rule change has to have attached to it a checklist which explains how each of the principles of good regulation have been met ...”.⁹⁵
108. We recognise that individual regulators were important in the initial stages of establishing a regulatory framework. They enabled a regulatory regime to be

⁹¹ See in particular Sir Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (London: Gee & Co Ltd, 1992); Sir Ronnie Hampel, *Committee on Corporate Governance: Final Report* (London: Gee & Co. Ltd., 1998); D. Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (London: Department of Trade & Industry, 2003); and *The Combined Code on Corporate Governance* (London: Financial Reporting Council, 2003).

⁹² See, for example, Q554 (Vol.II p194) and Vol.II p61, reply to q3

⁹³ Vol.II p23; Vol.II p138, para 12

⁹⁴ Q530, Vol.II p177; see also Vol.II p 166, para. 37

⁹⁵ Q857, Vol.II p302

brought into being relatively quickly and for decisions to be made with some expedition. The regulators who were appointed tended to be able and experienced individuals, who often demonstrated an innovative approach. However, we take a developmental view. We believe that it is appropriate on the whole that regulators appointed as individuals give way to the appointment of boards. Once a regulatory framework is in place, boards can offer not only an efficient structure but also the potential for greater stability than may be possible with an individual. By drawing on the expertise of the different members, they can test propositions and take a wider view than is possible with a single individual. We believe that a board is better placed than an individual regulator to avoid some of the pitfalls identified in the previous chapter, and to manage risk better.

109. We therefore welcome the move towards boards. We acknowledge the argument that a board may be a brake on innovation, but are satisfied that this objection is outweighed by the advantages. Regulated bodies may well not welcome extensive innovation anyway, especially if it gives rise to regulatory uncertainty. We also recognise the issue of representation: who provides the public face of the regulator? With an individual regulator, the answer is obvious; it is less so with boards.⁹⁶ Given the corporate board structure, there is a need for a public face. The Minister of State at the DTI, Mr Stephen Timms, whilst recognising the role of the chairman, suggested that some spreading of the role of regulatory spokesman might be helpful, stating “I guess it is likely to be the case that the chairman will have a particularly prominent role in the mind of the public at least, but that need not give rise to difficulty. In a sense it is helpful to emphasise the more corporate nature of the regulator, that there are perhaps one or two or more individuals who are associated with its decisions in the public mind”.⁹⁷ It is our judgement that, in addition to fulfilling their normal duties, the Chairman or Chief Executive should normally be the authoritative spokesman on regulatory decisions and related matters, although we would not wish to be over-prescriptive. The essential point is that each board should designate one of its number to be the principal face of the regulator. The role could be shared, but we believe that the balance is in favour of a single individual.
110. **We welcome the move towards more collective board structures, rather than sole regulators, as one of the principal mechanisms for improving the quality and consistency of regulatory decision-making, and urge that this should be the norm for regulatory regimes. To ensure that there is no loss of accountability we recommend that boards designate one of their number as the public face of the regulator in order not to lose engagement with the public and to perform the role of building confidence and understanding. Normally this should be the Chairman or Chief Executive. Where appropriate open meetings should be held as a means of increasing public understanding and confidence.**

⁹⁶ An HM Treasury view is set out in the Model Management Statement and Financial Memorandum for Executive NDPB's, stating at paragraph 3.4.3 that “the chairman has a particular leadership responsibility on”, inter alia, “representing the views of the Board to the general public”, p. 7, Model scheme for Accounting Officers, 27 March 2003.

⁹⁷ Q1124, Vol.II p399

CHAPTER 7: RELATIONSHIPS WITH MINISTERS – INDEPENDENCE AND ACCOUNTABILITY

111. Concerns have been expressed about the design of the regulatory framework with respect to the possible tension (or conflict) between independence of regulators (whether boards or individuals) and their accountability. Independent regulators, at arms length from Ministers, may be seen to be less accountable, or perhaps even unaccountable, compared with the traditional perception of Ministers being directly accountable to Parliament for their decisions. Clare Spottiswoode told us: “You want an independent regulatory body that takes the best decisions and, because it is independent, by definition it cannot be accountable to Ministers”.⁹⁸
112. But is this a fair reflection of the relationship between independence and accountability? We think not. John Vickers, Chairman of OFT, told us that “I am not sure that I would see a tension between independence and accountability”.⁹⁹ But independence has to be qualified in relation to working within, rather than independently of, Government.
113. We have received clear evidence that independence of regulators from Ministers is welcomed by Ministers and is seen as a vital ingredient for maintaining consistency, for ensuring that regulatory decisions are taken by ‘competent authorities’ (which accords well with current and prospective developments in the governance of the European Union), and for promoting confidence about regulation among the regulated, those investing in regulated enterprises, and the customers and citizens on whose behalf regulation is carried out. The Department of Trade and Industry told us, for example, that “the independence of economic regulators from Government - insulating decisions from short term political factors - is a fundamental contributor to regulatory certainty and prerequisite for continuing to attract private finance to regulated sectors”.¹⁰⁰
114. An exception is to be found in the evidence presented to us by the Rail Regulator, Tom Winsor, who clashed with Transport Secretary, Stephen Byers: “It was an extraordinary episode. I had no expectation that the Minister would ever take the steps that were taken in relation to me. If it was expected that I should be intimidated, I was not....I believe that for an independent regulator to give in to that political pressure, apart from being an irrelevant consideration as a matter of public law, or to resign would have been a very serious and adverse step for the constitutional position of regulators and the relationship between the state and the private sector in areas and in respects going far, far wider than the railway industry.... I think it is notable, and I claim no credit for this, that in the bill which is to be brought before parliament in relation to foundation hospitals, the title of the regulator is ‘the independent regulator’”.¹⁰¹
115. In this context, Ministers have clearly given up some freedoms, and regulators’ decision-making is protected. However, whilst their decision-making may be protected, they should be no less - and need not be any the

⁹⁸ Q423, Vol. II p142

⁹⁹ Q959, Vol. II p366

¹⁰⁰ Vol.II p373, para 9

¹⁰¹ Q606, Vol.II p222

less - accountable for their decisions. They have a duty to explain, they should be exposed to scrutiny, and be subject to the full rigours of the possibility of legal challenge. We have received much evidence that these disciplines apply. We have found no conflict in principle between independence and accountability.

116. The disciplines, however, should not be entirely one-sided, or available at any price. This could be a recipe by which self-interested parties could frustrate Parliament's intention and the exercise of good regulation. Equally, there should be disciplines in place to avoid those pitfalls of regulation which may themselves undermine the exercise of effective, accountable regulation.

Public bodies and independence

117. We have received evidence that the type of public body may affect the formal relationship with Ministers and hence the perceived or actual degree of independence. The Environment Agency told us of their internal debates about whether it would be better to be a Non-Departmental Public Body (NDPB) or a Non-Ministerial Department, given that the former provides more flexibility on pay and rations but the latter more freedom in the policy arena. Baroness Young of Old Scone told us that the final decision was based on the fact that it would be too expensive to become a Non-Ministerial Department subject to Civil Service conditions of service, but in any event they felt that the environment needed a Cabinet Minister "batting on behalf of the environment, fully informed by the sort of advice and information that we can give".¹⁰² Also she told us that whatever their status, their intention was to maintain their effective independence by being "seen as authoritative".¹⁰³
118. The evidence suggests that whatever level of independence has been granted by Parliament, Ministers have generally sought to maintain that independence, and that that independence is secured in the substantive role of the regulatory body in question. If that role is clear, then its independence is better secured. The distinction between policy and operations is especially important. Ministers determine policy and regulators put it into effect. Where that distinction has been recognised, there appear to have been few problems. Philip Fletcher answered the question for us: "Have I ever been leant upon inappropriately by Ministers? No. I am absolutely clear about that".¹⁰⁴ This was echoed by other past regulators.¹⁰⁵
119. Again, the processes for effective accountability play an essential role. Independence must first be explicit, and in that it is clear who has the final formal decision, but it must also be implicit, in that the independence of that final decision is, as far as possible, demonstrable. Where regulatory decisions are founded on clear, demonstrable and disinterested arguments and evidence, put into the public domain, then the assertion of regulatory capture by one or other interest group can be reasonably rebutted. It is the public accountability of regulators for those disinterested decisions which give effect to the demonstration of implicit independence as the central foundation of

¹⁰² Q987, Vol.II p347

¹⁰³ Q966, Vol.II p342

¹⁰⁴ Q587, Vol.II p207

¹⁰⁵ Q 167, Vol.II p63; Vol.II p42; Vol.II p141

regulatory independence. It also demonstrates that there is no conflict between accountability and independence.¹⁰⁶

120. The independence of regulators is both explicit, in the legal right to take final decisions, and implicit in the formulation of those decisions by the objective and impartial application of verifiable criteria equally to all concerned. Regulators not only have a duty to regulate responsibly, they have a duty to ensure that they are seen to be regulating responsibly. Decisions are, of course, subject to judicial review and, in many cases to appeal.
121. Our evidence suggests once again the broad range of support that underpins a regulatory framework that separates ministerial roles and responsibilities from those of independent regulators, and that this fact should be well communicated on a regular basis by Government. Water UK, for example, told us that “For Ministers and regulators frequently to reassert the independence of the regulator on economic decisions is helpful; and, after all, we had a survey of investors recently and 96 per cent of them said that they regarded the independence of the regulator as being very important, so just a frequent reassertion of it would be helpful”.¹⁰⁷ This view was matched by the view of the water regulator.¹⁰⁸ Equally, the same view was expressed by both the regulator (ORR) and the regulated (ATOC) in the rail sector.¹⁰⁹
122. **Government should explicitly accept overall responsibility and accountability for regulatory policy and the regulatory framework, while devolving responsibility under defined circumstances to independent regulators.**

Appointments, Nolan principles and re-appointment

123. Ministers take responsibility for appointing independent regulators in accordance with Nolan Principles. Independent regulators are accountable to Ministers for the independence and effectiveness of the regulation that they were appointed to carry out, and Ministers are jointly accountable with the regulators to Parliament for the consequences of those regulatory decisions. We disagree, therefore, with the line of argument that regulation implies that Ministers are absolved of all accountability to Parliament for the conduct of independent regulators. Both need to be held accountable with respect to the particular roles and responsibilities that they discharge in the regulatory framework as a whole.
124. It has been suggested to us that the power of reappointment by Ministers might undermine the independence of the regulators.¹¹⁰ Clare Spottiswoode told us that “Choosing a career civil servant as head of a regulatory body could compromise the appearance of independence”.¹¹¹ We have already identified the potential pitfall of a desire on the part of a regulator to be reappointed creating a conflict of interest by seeking favour with the Minister, where that favour implies carrying out the statutory duties of the

¹⁰⁶ See in particular *Independent Regulators* (London: Better Regulation Task Force, 2003), chapter 6: “Independent but accountable and answerable: a licence to operate”.

¹⁰⁷ Q338, Vol.II p116

¹⁰⁸ Vol.II p200, para28

¹⁰⁹ Vol.II pp215-6, paras 57 and 62; Vol.III p9

¹¹⁰ Vol.II p62, reply to q11

¹¹¹ Vol.II p141, para 50

regulator other than to the best of their ability. Tom Winsor told us that: “I think it can make you stronger if you have no expectation of reappointment”.¹¹² Most important is that independence is protected during the period of appointment, even though John Swift pointed out to us that a misjudgement in that appointment could have serious effects during its term. It was a question of balance.¹¹³ Nevertheless, as was pointed out to us by Sir Bryan Carsberg, in some circumstances a regulator might recognise the political realities resulting from their performance, and resign if necessary.¹¹⁴ We recognise that allowance has to be made for extreme circumstances, but such rare occurrences should not be seen to undermine the general principle of independence for the term of the appointment.

125. It is sometimes but not always the case that a single term appointment would be the answer. This is because the object of our attention is effective accountability. The power of appointment is a longer-term weapon in the arsenal of accountability. The power should work well as long as both independent regulators and Ministers are held fully accountable for their respective actions. What is important is that the Nolan principles are observed in all cases. We do not support the idea of an independent appointments commission. The appointments are being made in order to carry out public policy for which Government has responsibility. It reflects part of the checks and balances within the regulatory system as a whole, and, most fundamentally, carries the clear message that Ministers retain the responsibility, through a democratically elected Government, for the overall operations of the regulatory state.
126. **We recommend that Ministers should remain responsible for appointing regulators, subject to Nolan rules, to ensure proper responsibility and accountability.**

Ministerial guidance and independence

127. We have heard evidence that guidance from Ministers has not sought to compromise or constrain the independent regulators, but to provide a fuller picture of the policy context with which the independent regulators work. This is consistent with the statutory and organisational structure of the framework of regulation, and reflects the independence of regulators *within* the state, rather than *of* the state. Ofgem told us that “the government has made it clear that where it wishes to introduce social and environmental measures that would have a significant financial impact on consumers, it will seek to do so through new legislation”.¹¹⁵ John Swift told us that independence and accountability can be reconciled through the concept of answerability.¹¹⁶ Callum McCarthy set out the practical implications of the relationship in terms of “no surprises”¹¹⁷, that “friction”¹¹⁸ must be expected, that Ministers must present “serious” arguments,¹¹⁹ and that any guidance

¹¹² Q611, Vol.II p223

¹¹³ Q132, Vol.II p50

¹¹⁴ Q181, Vol.II p66

¹¹⁵ Vol.II p154, para 51

¹¹⁶ Vol.II pp40-41

¹¹⁷ Vol.II p184, para 52

¹¹⁸ Vol.II p185, para 3

¹¹⁹ Vol.II p187, para 10

on social and environmental matters should be focused and weighted between the various worthy duties.¹²⁰ Northumbrian Water gave evidence that regulators faced contradictions, conflicts and trade-offs, concluding that “the best that a regulator can do is to clearly identify the political questions, inform relevant stakeholders, and ensure a mechanism exists to obtain the necessary answers. When a regulator makes such decisions himself he is likely to be accused of exercising excessive discretion”.¹²¹ This view was supported by United Utilities, but who added “this guidance needs to be as unambiguous as possible, particularly when Government has conflicting objectives”.¹²²

128. Nevertheless, the potential for tension remains in that Ministers might from time to time seek to re-establish a role which is inimical to independent regulation, the purpose of which has statutory recognition. Clear accountability of both regulators to Ministers for their independence, and of regulators and Ministers to Parliament is the best defence against the erosion of effective, independent regulation.
129. Advisory bodies which help Ministers carry out their regulatory role more effectively also need to be more closely integrated where that is appropriate. The role of the Environment Agency in the preliminary process of drafting statutory regulation is a case in point. The Environment Agency told us that they would “like a shift in the dividing line between our role and our Government sponsor’s role”. They felt it was important “to be in the position where perhaps jointly, with our Government sponsors we were tasking the lawyers with the design so that we were in on the ground floor, as it were, of the design”.¹²³ We concur that regulators should be fully involved in the preparation of regulatory legislation in order to facilitate the development of the most effective and practicable statutory framework.
130. **Regulatory legislation should normally be drafted in the light of consultation with regulators to achieve clearly defined objectives. The duties imposed on regulators should be consistent with the overall remit of the regulator (for example, economic regulation). They should make clear the underlying purpose of the regulator’s role (such as consumer protection).**

¹²⁰ Vol.II p187 para 11

¹²¹ Vol.III p127, para 15

¹²² Vol.II p109, para 11

¹²³ QQ988 & 989, Vol.II p347

CHAPTER 8: IMPROVING THE FRAMEWORK OF REGULATION

The 'whole of Government' view

131. It follows from the previous chapter that there should be a '*whole of Government*' view of regulation, and hence of the accountability of regulators to citizens and Parliament. The OECD has articulated this perspective consistently since 1997 through its project on Regulatory Reform, both in its individual member country studies, and notably its overview studies.¹²⁴
132. The whole of Government view is concerned with the overall, integrated design of the regulatory state, for the effective separation of regulatory roles and responsibilities, and for ensuring internal control through the discipline of the three elements of accountability. Where these prove not to be effective, then there is a need for reform. The OECD review of regulatory reform in its member states provides sound advice, for example: "at the institutional level, an essential element of the substantive appraisal of new regulations is their review by a body that is independent of the regulator proposing the regulation, ideally located at the centre of government.....to ensure a 'whole of Government' perspective is taken".¹²⁵
133. The whole of government view can therefore be divided into two parts: macro and micro. First, the macro part which concerns the design of the regulatory framework as a whole, where that framework divides roles and responsibilities in a rational way, focused on the desired outcomes of regulation, and incorporates the necessary checks and balances of accountability within the system. Government and Parliament are responsible for the design of a good regulatory framework and incorporating it into statute, and therefore should be accountable for that. Good design will include criteria such as well-aligned incentives to efficiency and cost-effective regulatory outcomes. The disciplines of the cost-benefit test should therefore be equally applicable to all regulators.
134. Secondly, the micro part related to the regulation of particular sectors or activities. Devolved, independent regulators are responsible in many instances, for reasons of good regulatory design, for the operational implementation of regulation, within the law, and should be accountable for their decisions and any discretion that they are able to exercise. Where their performance is limited by the acts that empower them, or the design of the regulatory framework, Government and Parliament have to be accountable for that causation. The procedures of accountability need to be able to identify this co-responsibility in practice.
135. The notable feature which has arisen from the evidence is the fact that the institutions of regulation are so often matched with the type of regulatory problem to be addressed, rather than being multi-purpose regulatory bodies. Most notably, economic regulators have been given statutory powers to address the problems of the abuse of monopoly power and carry out that role independently of Ministers. The DTI emphasised that "the economic regulators have been established in different ways at different times over the

¹²⁴ See in particular Report on Regulatory Reform (Paris: OECD, 1997) and United Kingdom - Challenges at the Cutting Edge (Paris: OECD, 2002).

¹²⁵ Regulatory Policies in OECD Countries - From Interventionism to Regulatory Governance (Paris: OECD, 2002), p. 33.

past three decades. They share an essential justification to protect consumers against potential abuse of monopoly power, introducing competition where appropriate and regulating prices where necessary”.¹²⁶

136. This institutional separation allows increased focus on the problem and the application of technical judgement by a competent authority.¹²⁷ The regulator is typically an appointee or Board, working to clear statutory authority, and there should be no democratic deficit where the accountability of the regulator is effectively exercised throughout the three processes of accountability we have identified. The regulator is carrying out statutory functions delegated to him by Parliament for the regulatory purposes determined by Parliament.
137. Independence from Ministers provides for consistency of practice, undistorted by short-term political considerations. Independence has been granted by Parliament for a purpose, and must therefore be matched by due accountability.
138. **Responsibility for environmental and social standards should normally remain with Ministers as the authority of a democratic mandate is required for decisions in these areas.**
139. Institutional separation of roles and responsibilities in the regulatory state is therefore seen as important to the achievements of effective accountability, and hence effective regulation. Regulatory governance and accountability run hand-in-hand, such that: “the OECD’s work on governance includes a substantial emphasis on regulatory policies as a fundamental part of the work necessary in pursuit of the goals of:
 - transparency
 - accountability
 - legitimacy
 - efficiency
 - policy coherence”
140. But it has a word of warning: “The concept of transparency in government has rapidly become a central theme in governance literature and in public debate the term transparency is itself non-transparent, being understood to mean quite different things by different groups. In its largest sense, transparency can be understood in terms of the relationship between state, market and society. Transparency is an essential part of all phases of the regulatory process, as well as the management of the regulatory system”.¹²⁸
141. The work of the OECD is also valuable in that it has produced a checklist for regulatory legislation and decision-making. This is shown in Table 4.¹²⁹ It is particularly relevant to the purposes of our inquiry. The checklist is clear and

¹²⁶ Vol.II p372, para 4.

¹²⁷ See for example Appendix 5.

¹²⁸ pp. 100 and 65 respectively in *Regulatory Policy in OECD Countries - From Interventionism to Regulatory Governance* (Paris: OECD, 2002).

¹²⁹ Recommendation of the Council of the OECD on Improving the Quality of Government Regulation, OECD/GD (Paris: OECD, 1995). This adopted for the first time an internationally accepted set of principles on ensuring regulatory quality, and included the 10 point OECD reference checklist: OECD, *Regulatory Policy in OECD Countries* (Paris: OECD, 2002), p23.

covers in our view the relevant questions appropriate to a regulatory decision. It is one that we believe could, and should, stand as the template for regulatory decision-making.

TABLE 4
OECD regulatory checklist

<ul style="list-style-type: none"> • Is the problem correctly defined? • Is Government action justified? • Is regulation the best form of Government action? • Is there a legal basis for regulation? • What is the appropriate level (or levels) of Government to take action? • Do the benefits of regulation justify the costs? • Is the distribution of effects across society transparent? • Is the regulation clear, consistent, comprehensible and accessible to users? • Have all interested parties had the opportunity to present their views? • How will compliance be achieved?

142. **We recommend that the OECD regulatory checklist be utilised as standard for legislation, regulatory decision-making and in establishing any new regulator.**

The Better Regulation Task Force (BRTF) role and recommendations

143. The BRTF¹³⁰ has in recent years sought to carry out an important element of the central whole of Government role envisaged by the OECD. It has promulgated five principles of good regulation:

- transparency
- consistency
- proportionality
- targeting
- accountability

144. Indeed, in the course of this Inquiry it has published three reports with recommendations which seek to improve the accountability of regulators, and hence the discipline on regulators and their activities.¹³¹ These were:

- **Regulators: Getting the Message Across** - which includes the recommendation that Government should publish short summaries of the underlying objectives when promoting legislation.¹³²

¹³⁰ The BRTF is an independent advisory group, established in 1997. Its members come from a variety of backgrounds, and are unpaid. Its terms of reference are “to advise the Government on action to ensure that regulation and its enforcement are proportionate, accountable, consistent, transparent and targeted”. Officials from the Cabinet Office’s Regulatory Impact Unit provide support.

¹³¹ See also its earlier report on Economic Regulators.

¹³² BRTF, *Environmental Regulation: Getting the Message Across* (London: Cabinet Office, 2003).

- Imaginative Thinking for Better Regulation - which includes recommendations that regulatory impact assessments should consider alternatives to classic regulation (and analyse the potential for unintended consequences), and that there should be self-assessment by regulators of the quality of their regulation in their annual reports.¹³³
 - Independent regulators - which makes various recommendations for the effective accountability of independent regulators, including statutory duties to have regard to the five principles of good regulation, and a commitment on all regulators to prepare regulatory impact assessments.¹³⁴
145. We strongly endorse the work of the BRTF and its report on independent regulators. Some of its recommendations complement or reinforce those we have already made, such as its Recommendation 9 in favour of independent regulators having boards. We very much welcome its Recommendation 12 that all independent regulators should produce and make available for public scrutiny a Regulatory Impact Assessment (RIA) on all new major policies and/or initiatives that will impact on those they regulate. We believe RIAs, both pre- and post-regulation, are essential in the regulatory process and impose a necessary discipline on regulators. We agree with the Government in its response that the RIA process is sufficiently flexible to be appropriate for the needs of the regulators. We also concur with the Task Force's recommendations, among others, aimed at increasing the transparency and accountability of regulators, including open meetings and agreeing a management statement with the sponsor Department. We concur with the Task Force's recommendations and we welcome the Government's positive response to those recommendations. We are especially pleased that the Government have accepted the case for a RIA on all new major policies or initiatives. We see our task as to complement the work of the BRTF and to build on its recommendations.
146. **The recommendation of the Better Regulation Task Force (BRTF) that regulators should produce Regulatory Impact Assessments (RIAs) on all new major policies and initiatives has been accepted by the Government and should be applied throughout the system. We also endorse the Task Force's recommendations, among others, aimed at increasing the transparency and accountability of regulators, including open meetings and agreeing a management statement with the sponsor Department.**
147. We recognise from the BRTF's work the fundamental contribution which the articulation of a high level mission and core principles related to effective regulation can have on improving accountability and achieving and maintaining effective regulation. We note, however, the OECD's views, and thereby draw attention to the fact that the BRTF's five principles do not focus as well as they might on the need for clear objectives for regulation, rationality and objectivity of approach, and overall coherence of regulatory policy. It is there in the sub-texts but not as explicit as it could be.¹³⁵ It

¹³³ BRTF, *Imaginative Thinking for Better Regulation* (London: Cabinet Office, 2003).

¹³⁴ BRTF, *Independent Regulators* (London: Cabinet Office, 2003).

¹³⁵ For example, in the headlines of the policy maker's checklist, transparency is initially described by the by-line "Regulators should be open, and keep regulations simple and user-friendly" followed in the sub-text by important references to policy objectives: BRTF, *Principles of Good Regulation* (London: BRTF, 2003) p5.

should be. This is because all three of these terms focus directly on the question of legitimacy of regulation, an aspect which the OECD clearly identifies as a fundamental goal of good regulatory governance, and hence is a prime target for the focus of accountability.

148. **We recommend that the BRTF review its principles of good regulation to ensure that the principles of coherence, objectivity and rationality of approach are incorporated and signalled to the wider public.**

A guardian of good regulation at the heart of Government

149. The BRTF report on independent regulators referred to the proliferation of regulatory bodies, and its concern with the impression it had formed that some Government departments did not seem fully aware of which regulatory bodies fell within the ambit of their responsibility. This was not helped, in their opinion, by the fact that the Cabinet Office's own publication, *Public Bodies*, did not give a comprehensive coverage, but only a snapshot aimed at primarily executive non-departmental public bodies.¹³⁶ We concur with this concern because clarity about the framework of regulatory roles and responsibilities is an essential element in achieving effective accountability. However, our substantive concern relates to communication of the structure of Government's regulatory bodies to a wider audience, including citizens and Parliament, rather than to a concern that there is a fundamental failure of control by Government and its departments over regulatory bodies.
150. The information is there, but difficult to assemble from disparate sources,¹³⁷ and we are sure it is well founded through the Treasury procedures for appropriation and resource accounts, which identify all public bodies, as appropriate via their inclusion in the structure of the appropriation accounts. The Cabinet Office, however, can clearly improve its presentation of the overall framework to a wider audience. The evidence suggests one reason for this lack of a coherent view, and its effective promulgation, contrary to OECD good practice advice, is that responsibility for the whole of Government view of regulation is dispersed amongst various departments, including the Cabinet Office, the Treasury, the DTI and the Prime Minister's Office.¹³⁸ Each of these clearly has an interest, but effective co-ordination and presentation requires that a single institution should be identified as having the primary proactive responsibility for co-ordination and promulgation of the whole of Government view. The Cabinet Office is best placed to assume and carry out that role. And, as the Electricity Association has commented, Ministerial coordination can be enhanced accordingly, given that there is already a Cabinet Committee concerned with regulatory accountability.¹³⁹
151. The lack of knowledge among Departments also masks the fact that there are different regulatory models in existence. This leads to disparate forms of regulatory control, generating some degree of inequitable treatment across the regulatory regime. A more co-ordinated view of regulation would enable

¹³⁶ See in particular section 3.1 of the BRTF report, *Independent Regulators*, p14.

¹³⁷ See for example Appendix 6.

¹³⁸ Q1115, Vol.II p397; Vol.II p372, para 1; Vol.II p164, para 23

¹³⁹ Vol.II p164, para 16

these inequities to be addressed and for regulatory models to be applied in like circumstances.

152. **There must be a much stronger co-ordination of the ‘whole of Government’ view of regulation. We recommend that the Government appoint a lead Department to be responsible for promoting effective regulation in practice, thereby co-ordinating the various roles currently played by a number of departments, including HM Treasury, DTI, the Cabinet Office and the Office of the Prime Minister. Logically, the Cabinet Office should assume this role, possibly by expanding the remit of its RIA unit. Its responsibilities should mirror those we outline for a parliamentary committee in paragraphs 199 to 203.**
153. **It is also important that there should be consistency in applying regulatory models and requirements on a like-for-like basis.**

Other aspects

154. Two particular aspects of the overall regulatory framework emerge from the evidence related to the effectiveness of accountability in practice. First, the increasing formalisation of inter-regulatory relationships. This has taken place most notably through the preparation of memoranda of understanding (MOU), management memoranda, concordats and other such written agreements.¹⁴⁰
155. We take note, however, that memoranda of understanding are not necessarily solutions of underlying problems of, say, a flawed regulatory structure. Bureaucratisation in this sense is at best a panacea, giving the impression of workability and accountability, but it rarely lasts. WaterVoice told us that: “We do not think an MoU is a proper substitute for strong powers for the CCW” (Consumer Council for Water).¹⁴¹
156. Secondly, there is the development of self-regulation. This is entirely to be welcomed in that it can minimise the bureaucracy and cost of state regulation. It can only be sustained where self-regulation is shown to be an effective substitute, or surrogate, for the state’s responsibility to address the identified market or conduct failure. Co-regulation may be one way for effective regulation and accountability to be maintained.¹⁴² Ofcom has a statutory duty to have regard to the desirability of promoting and facilitating effective self-regulation, but recognises that self-regulation has to be judged against its achievements in acting as a surrogate for the public regulation which would otherwise be in place. Ofcom told us that it “intends therefore to develop and publish a series of criteria, covering for example transparency and effective audit, which it will adopt in deciding whether to pass any activities to co-regulatory or self-regulatory bodies”.¹⁴³ We concur with Ofcom that this is the appropriate approach and will allow Parliament to hold Ofcom accountable for its control of self-regulatory and co-regulatory arrangements. This model offers the opportunity for some public oversight.

¹⁴⁰ Vol.II p257, para 37; Vol.II p240, para 19; Vol.III p 63, para 18

¹⁴¹ Vol.II p120, para 26

¹⁴² See in particular chapter 8 on self and co-regulation in the BRTF report:: *Imaginative Thinking for Better Regulation* (London: Cabinet Office, 2003), pp. 41-48

¹⁴³ Vol.II p416, paras 2.3 and 2.4

157. **The move towards self-regulation should be encouraged and co-regulation should, where appropriate, be used as a preliminary to it.**

CHAPTER 9: IMPROVING OPENNESS, INFORMATION AND COMMUNICATION

The qualitative characteristics for effective accountability

158. Accountability is only useful, or effective, as a control mechanism if it influences regulatory behaviour and decisions. That is to say, consequences result from accountability, whether immediate or in due course, either by:
- confirming that on-going regulatory practice is performing well;
 - occasioning changes to improve that performance short or long term;
 - constraining certain regulatory outcomes, for example by judicial review.
159. The effectiveness of accountability depends on qualitative characteristics which apply to:
- (1) The provision of information from the accountable party, which should be, for example:
 - relevant (that is, relevant to decisions)
 - timely
 - consistent
 - material
 - comprehensive in coverage, rather than detail
 - accurate
 - promote substance over form
 - (2) Good work on defining the qualitative characteristics of reported information has been carried out by the standard-setting bodies, such as the Accounting Standards Board and the Financial Reporting Council.¹⁴⁴
 - (3) The use of information by those scrutinising the accountable party, which are, for example:
 - sufficient knowledge of the regulator's role and responsibilities and their place in the regulatory scheme as a whole;
 - a fair basis for evaluating the information provided;
 - the opportunity and knowledge/skill to participate and to take unsatisfactory outcomes further if required.
160. In regard to improved disciplines on regulators through the processes of accountability, we have received much support for the development of regulatory impact assessments by regulators. These improvements to accountability have been complemented by, first, a growing emphasis on the role of each regulator's annual report, and the requirement for published forward programmes about planned activities, the success or failure of which should be consistently covered in successive annual reports, and, secondly, a commitment at the centre of Government to impose institutional

¹⁴⁴ See in particular *The Corporate Report, A Discussion Paper* by the Accounting Standards Steering Committee (1975), and *Statement of Principles for Financial Reporting* published by the Accounting Standards Board (1999), which sets out the qualitative characteristics for information to be relevant to users.

mechanisms for instilling the principles of good regulation into practice, setting standards for consultation, and monitoring the effectiveness of regulation. We received much evidence on the intention to achieve best practice.¹⁴⁵

161. The practical requirements for carrying out good RIAs have been extensively researched and promoted through advice and guidance by both the Cabinet Office's Regulatory Impact Unit (RIU)¹⁴⁶ and the National Audit Office.¹⁴⁷ There is clearly no shortage of information available to regulators on how to prepare RIAs properly. The requirement now is for regulators to meet the challenge and provide information through RIAs which can be used to hold them effectively to account. The experience of producing RIAs will improve them over time, and parliamentary scrutiny, complemented by the on-going monitoring work of the RIU and NAO, will play an important part in ensuring that improvement takes place.
162. The European Commission has also recognised the key importance of RIAs in promoting better accountability and good governance. The Commission's vision was set out in its 2001 White Paper on governance.¹⁴⁸ This has been supported by a succession of practical documents supporting the Commission's better regulation 'package' of initiatives issued in 2002.¹⁴⁹ The result of this initiative is that the Commission's policies have to be supported by RIAs, developed by the appropriate responsible directorate within the Commission. Therefore there are, and will increasingly be, European comparators available to inform and challenge UK practice in this area, and thereby assist progressive improvements in RIAs and regulatory accountability. The Committee visited Brussels in October 2003 to discuss this and related issues.¹⁵⁰
163. The regulated clearly support an effective RIA process and achieving this would do much to reduce criticism and promote better understanding and acceptance of necessary regulation: "Innogy would like to see the RIA process introduced quickly and comprehensively and believes that it could be sensibly applied to some current policy areas ... Scrutiny of regulators needs to include assessment of the accuracy of the RIAs".¹⁵¹ The point they make about looking back to see how well the original RIA worked out in practice is an important one. Such reviews of RIAs should be part of the normal regulatory process. Equally it applies to legislation, and we can concur with the UK mobile operators when they told us "Lord Fowler, in the second reading of the Communications Bill in the House of Lords, 25 March 2003

¹⁴⁵ QQ315 (Vol.II p112), 1120 (Vol.II p398), & 1062 (Vol.II p367); see also Vol.II p420, para 9.1

¹⁴⁶ See in particular: A Quick Guide to Regulatory Impact Assessment (London: Cabinet Office, 2003), supported by its detailed guidance, Better Policy Making; A Guide to Regulatory Impact Assessment; and Regulatory Impact Assessments; 1st January to 30th June 2003, CM5981.

¹⁴⁷ Better Regulation: Making Good Use of Regulatory Impact Assessments, 15 November 2001, HC329, 2001-02.

¹⁴⁸ European Governance - A White Paper, 428, Final, Brussels, 2001

¹⁴⁹ See in particular: The Mandelkern Report on Better Regulation, Final Report, Brussels, 2001; Communication from the Commission on Impact Assessment, Com, 276, Final, Brussels, 2002; and Impact Assessment in the European Union, Quality and Good Regulatory Governance, European Commission, Conference Background Report, Brussels, 3 December 2003, prepared by Professor Claudio Radaelli.

¹⁵⁰ See Appendix 7 for a summary of the evidence.

¹⁵¹ Vol.III p105, para 15

said: ‘...it has often seemed to me that what is needed with much legislation is not only pre-legislative scrutiny but post-legislative scrutiny, to see how the government’s plans have worked out in practice. In my experience, it is the lack of objective checks after legislation has been passed that too often runs us into trouble’. These sentiments capture succinctly the views of the UK mobile operators”.¹⁵²

164. The British Air Transport Association (BATA) was particularly concerned that the process should be effective because “Although aviation pays for the CAA, it has little influence on the size of its budget nor on how the money is spent. The accountability of the CAA to aviation and hence to citizens, who are aviation’s customers, is poor”. Our concern is that an RIA has to be used in the process of empowering both citizens and the regulated, a concern which was well expressed in subsequent evidence from the BATA: “The CAA is obliged to carry out a Regulatory Impact Assessment (RIA) before bringing in new regulations but we are not consulted during the RIA process. Obviously, we believe we should be consulted but it would be even better if workshops were held early in the planning phase. This should lead to improvements in regulations and safety being implemented in a more cost effective manner”.¹⁵³ British Energy summed up the need for improvement thus: “However, this must ensure that the RIA is comprehensive, an integral part of the consultation process, includes a full cost-benefit and environmental impact analysis, and is conducted in accordance with best practice as set out in the NAO’s report on regulatory impact assessments published in November 2001”.¹⁵⁴
165. There are on-going concerns, however, about consistency in the whole of Government view of regulation. New legislation, such as the Financial Services Act 2000, the Utilities Act 2000 and the Communications Act 2003, provided the opportunity to introduce new accountability requirements on regulators, and this is to be welcomed.

Codifying statutory duties relating to accountability

166. In the Ofcom and Water bills, and the Utilities Act 2000, duties on accountability have been developing. A codified list might in due course be helpful as the basis for all regulatory legislation. Table 5 summarises the possibilities and the practical consequences for regulatory practice.
167. However, there are exceptions to the right of the National Audit Office to carry out value for money studies on regulators. The most notable exception is with respect to the FSA. The Government and Parliament have, however, granted the NAO access to Ofcom, even though this is technically a public corporation. We return to this issue in Chapter 10.
168. The evidence shows general support for incorporating requirements of best practice into legislation. Water UK told us that “We think the principles of better regulation should be statutory duties on which Ofwat should report to Parliament”.¹⁵⁵ Ofcom concurred¹⁵⁶ and John Swift confirmed that a

¹⁵² Vol.II p436, para 5.7

¹⁵³ Vol.III pp16-17, paras 4 and 17

¹⁵⁴ Vol.II p94, para 25

¹⁵⁵ Vol.II p107, para 30

¹⁵⁶ Vol.II pp417 & 419 (paras 4.2 and 7.3)

perceived lack of transparency in the early 1990s was rectified by the inclusion of appropriate further statutory duties, in this case ensuring that the regulated firm could plan for the future with a reasonable degree of assurance.¹⁵⁷ The Government also noted its commitment to best practice, and, although it told us that no over-arching duty to consult exists, that “the regulators have committed to the use of extensive, transparent public consultation exercises covering significant decisions on policy development (eg, on licence conditions, regulatory methodologies – including explanation of thinking before decisions are reached – and forward work programmes), charges and periodic reviews”.¹⁵⁸ Support for the Communications Act 2003 provisions which increase the accountability of Ofcom was evident. As the UK mobile operators stated: “...Ofcom will be under an obligation to review regulation on a regular basis and remove any regulations that are unnecessarily burdensome or superfluous. If used correctly, this is potentially a very useful measure”.¹⁵⁹

169. Regulators should have a statutory duty to have regard to the principles of good regulation and effective accountability. These should include self-assessment of their compliance with the same; the design of effective consultation procedures to engage interested parties; ensuring that redress and compensation procedures are clear and accessible; and incorporating the outturn of plans in their annual reports. They should also include the publication of the following:

- (a) their mission statements;**
- (b) codes of practice for the conduct of their regulatory office;**
- (c) codes of practice for consultation (including the duty to summarise and accept or rebut consultees’ comments, with reasons);**
- (d) their forward plans;**
- (e) the explanations of and reasons for their decisions; and**
- (f) all relevant material necessary for their production before and after RIAs.**

¹⁵⁷ Vol.II p41 (q7)

¹⁵⁸ Vol.II p377, para 39

¹⁵⁹ Vol.II p435, para 4.3

TABLE 5

Accountability through statutory duties: duty to explain - provision of information

<i>Statutory duties to:</i>	<i>Practical consequences for regulators and regulatory offices</i>
<ul style="list-style-type: none"> • articulate the regulatory mission • exchange information based on memorandums of understanding • apply the principles of good regulation • have regard to any other regulatory best practice • prepare regulatory impact assessments, incorporating cost-benefit tests • publish all relevant information • prepare appropriate codes of practice • research customer and other interested parties' views • consult • facilitate responses to consultation • consider and give reasoned, and written, responses to consultation • give reasons for decisions • review regulatory impacts on a regular basis • publish particular document (eg, annual report/forward programme) and give information linking the two • subject to not prejudicing particular, or individual, commercial or private interests 	<ol style="list-style-type: none"> 1. Public relations and general education programme, plus in particular <ul style="list-style-type: none"> • memorandums of understanding • response to ministerial guidance (S of S to consult and have regard to C/B test) • publish forward work programmes 2. Develop RIA practice and codify methodologies 3. Codes of practice on: <ul style="list-style-type: none"> • administrative standards for the regulatory office (customer charter - how we discharge our functions) • appointments and related matters • consultation procedures and outcomes (or comply with Cabinet Office code) 4. Develop consultation methods and engagement with interested parties <ul style="list-style-type: none"> • hierarchical design (strategic to detail) • multimedia approach • workshops for specialists • public forums 5. Annual report: <ul style="list-style-type: none"> • include self-assessments of regulatory impact • statement of policy with respect to penalties
<p>Note: statutory power of consumer councils to obtain information from regulatory authorities</p> <p>rights to appeal (as appropriate)</p> <p>specified circumstances (eg, unreasonable penalties for contravening a licence condition)</p> <p>merits of the case</p>	

170. We are conscious, however, that consultation, though necessary and desirable, can also be a burden. Consultation is a consequence not only of proposals originating with regulators in the UK. Sir Howard Davies noted in his evidence to us that “there is a wave of European Directives under way which we are required to implement ... the second track has been the outcome of the various government consultations ... we are not the only people at fault here”.¹⁶⁰ Mr Jurgen Tiedje, Secretary of the European

¹⁶⁰ Vol.II, p308

Securities Commission, told us of the extensive consultation undertaken by the European Commission. He also noted that many market participants did not fully grasp the tight deadlines to which the Commission often had to work.¹⁶¹ The consequence of extensive and frequent consultation, sometimes with short deadlines, is that many regulated bodies cannot keep pace with the process. This is especially the case for small firms that are subject to a regulatory regime. Keeping abreast of consultations, and responding to them, can be demanding and time-consuming. As such, it is expensive.

171. The Rt. Hon. John Gummer MP drew our attention particularly to the burden on Independent Financial Advisers. This arose for three reasons. First, independent advisers are small businesses¹⁶²; second, the volume of consultation; and, thirdly, the complexity of the documents. He told us that “the difficulty we face is that small firms find it hard to be listened to even though the weight of regulation falls very heavily upon them, and even upon us who represent them”. He went on to say that this is because, with FSA consultations, “in each case they are proportionate, but if you add them together they are disproportionate”, and because “it really is very often made worse by the length and impenetrability of the documents”.¹⁶³
172. We believe that regulators should have particular regard to the needs of those they are consulting. We have drawn attention in Chapter 5 to the pitfall of presumption, which encompasses excessive requirements for information. It is essential that regulators create a consistent means of consultation that enables sufficient information to be gleaned from the bodies affected by regulation while ensuring that the demands for information do not unnecessarily drain the resources of those bodies or put them in a situation where they are unable to respond. Achieving such a structured position may itself be the product of consultation but such an exercise may be beneficial in reducing future burdens on the regulated.
173. **Regulators should adopt a structured approach to consultation designed to minimise the burdens on those consulted and to facilitate their engagement with either the principles or the detail as appropriate to the interests of those consulted.**

¹⁶¹ See Appendix 7

¹⁶² Of which there are some 18,000 represented by the Association of Independent Financial Advisers: “IFAs are, atypically for financial institutions, primarily small businesses and the regulator has particular challenges to develop a relationship with such businesses” - written evidence of the AIFA, (paragraph 1)

¹⁶³ Q737, Vol.II pp268-269

CHAPTER 10: IMPROVING PARLIAMENTARY SCRUTINY

174. Parliament is crucial to ensuring accountability. It not only creates the regulators by statute, it also calls ministers to account for the policy that is implemented by the regulators and acts on behalf of citizens in ensuring that ministers and regulators are acting in the public interest. Hence its place at the apex in Figure 1 (paragraph 48). The Figure itself does not do full justice to Parliament's place in accountability. Those bodies that have no formal power to require regulators to respond can make representations to Parliament to seek action and redress. If Parliament is not working effectively, then accountability cannot be delivered.
175. Parliament receives representations from a wide range of bodies and individuals.¹⁶⁴ Citizens, be it as individuals or represented collectively through an organised group, have increasingly made contact with parliamentarians. There has been a substantial increase in mail received by members of both Houses. In the mid-1960s, the number of letters received by MPs was 10,000 a week. By the mid-1990s, it was 40,000 a day. In 2003, the total number of items of post received in both Houses of Parliament was 12.5 million.¹⁶⁵ In addition to letters, MPs and peers receive a growing number of e-mails and telephone calls and spend considerable time in meetings with constituents and representatives of interest groups.
176. Citizens thus make ample use of the opportunity to contact parliamentarians. What, though, can and does Parliament do to ensure that their interests are protected? How does Parliament engage in scrutiny of Government and regulators? There are various tools available to Members of Parliament to subject Ministers to scrutiny and influence. These include debates and Question Time. Ministers appear at the despatch box to justify their actions and answer questions. Regulators, however, do not appear at the despatch box. For parliamentarians to scrutinise the performance of regulators, they have to utilise committees.
177. Parliament scrutinises the regulators primarily through select committees of either House or joint committees.¹⁶⁶ Most notably in terms of the scrutiny of independent regulators there are regular inquiries by:
- The Public Accounts Committee (PAC);
 - Departmental select committees of the House of Commons;
 - Cross-cutting (thematic) committees, such as the Public Administration Committee and Environmental Audit Committee.
178. The PAC is directly supported by the NAO, whose reports on audited accounts and value for money studies precede PAC inquiries of their own.

¹⁶⁴ See Philip Norton: 'The United Kingdom: Building the Link between Constituent and MP', in Philip Norton (ed), *Parliaments and Citizens in Western Europe* (London: Frank Cass, 2002), pp. 19-42, and Philip Norton, 'The United Kingdom: Parliament under Pressure', in Philip Norton (ed), *Parliaments and Pressure Groups in Western Europe* (London: Frank Cass, 1999), pp. 19-42.

¹⁶⁵ House of Lords: Official Report (Hansard), Vol. 656, WA 117 [19 January 2004]. 80 per cent of these were received in the House of Commons, 20 per cent in the House of Lords.

¹⁶⁶ Annex 3 of the DTI written evidence (Vol.II pp385-387) and Annex A of the NAO written evidence (Vol.III pp119-120) supply this information in chronological and tabular form.

179. Departmental select committees scrutinise the expenditure, administration and policy of particular Government departments and the regulatory bodies sponsored by those departments. The Trade and Industry Committee, for example, has within its remit Postcomm and the Gas and Electricity Markets Authority (GEMA). Thematic committees cut across departmental responsibilities, and therefore may also scrutinise the regulators: for example, the Environmental Audit Committee has carried out inquiries on water services and called Philip Fletcher, the then Director General, before them.
180. Given that parliamentary scrutiny is at the heart of the system for holding regulators to account, its effectiveness is of paramount concern. We have heard evidence that parliamentary scrutiny is effective, and there is strong support for that scrutiny to be effective. “Parliamentary select committees and the National Audit Office have effectively held regulators accountable for their actions”.¹⁶⁷
181. However, we have also heard that parliamentary scrutiny can be ineffective, either in not addressing the substantive issues in sufficient depth, or being diverted from, or trivialising issues, for reasons of political gaming alone, or missing areas of inquiry which could, or should, have been pursued. Sir Bryan Carsberg told us that parliamentary scrutiny was less demanding than he might have expected.¹⁶⁸ British Energy was frank: “... the lack of any direct incentive on Ofgem to control its costs and hence prioritise its work remains a cause for concern. Scrutiny by such bodies as the Trade and Industry Select Committee (TISC), the National Audit Office (NAO), the Public Accounts Committee (PAC) and the Treasury does not appear to have had any meaningful effect”.¹⁶⁹ The Royal Mail told us “With regard to the two key documents that Postcomm do produce, which are their annual report and their annual work plan, there is not any regular select committee scrutiny of those documents and they are not held accountable for what is in them”.¹⁷⁰ The Equitable Members’ Action Group - whose comments can now be placed in the context of Lord Penrose’s recent report (2004) - said that: “the FSA’s performance of doing nothing was disgraceful, and it should be held to account.... there is no effective means for consumers to achieve this and seek redress for the FSA’s neglect of their interests” and that “We believe the FSA is not satisfactorily accountable to Parliament. We recommend that the National Audit Office should be empowered to undertake efficiency studies of the FSA, and that the Parliamentary Ombudsman should be empowered to investigate it for maladministration”.¹⁷¹
182. We are very conscious of the critical nature of evidence we have received about the role of parliamentary scrutiny, and the need for Parliament to give serious consideration to the way in which it carries out its scrutiny, and the effectiveness of that scrutiny.¹⁷² However, we also take note of warnings that

¹⁶⁷ Vol.II p22

¹⁶⁸ Q197, Vol.II pp68-69 and Vol.II p62, qq6-8

¹⁶⁹ Vol.II p92, para 4

¹⁷⁰ Q639, Vol.II p233

¹⁷¹ Vol.III p98, paras 5 and 7

¹⁷² Vol.III pp79-81 (paras 3, 4, & 10); QQ601 & 602, Vol.II pp220-221; Q114, Vol.II p45 and Vol.II p37; Vol.II p139, para 25.

parliamentary scrutiny should be effective, not overdone.¹⁷³ Parliament perhaps needs to pay more attention to the information it requires.¹⁷⁴

183. Three issues raised, therefore, are those of capacity, consistency, and co-ordination.

Capacity

184. The capacity for effective scrutiny depends on the skill and resources available to the committee. In part this relates to the resources and experience of the individual committee members, in part to the support services available to the committee, whether through the clerk and the secretariat, specialist advisers or access to other professional sources. It also relates to the continuity of experience available to the committee, and the balance of the membership. We have heard evidence that select committees cannot be effective if they are under-resourced and particularly compared to the regulators they hold to account. “If, for example, a select committee wanted to have a clear understanding of how the commission, through a series of reports ... had dealt with and implemented a particular broad issue (eg cost of capital) ... I do not think that is possible without considerable expert advice”.¹⁷⁵
185. It is a question for Parliament whether its select committees are adequately resourced to maintain the effective level of scrutiny of regulators which Parliament itself desires. On the positive side, we note that resources have increased in recent years and some committees, such as Defence, have proved very active in drawing on the services of a range of specialist advisers. Much more extensive use has also been made of the National Audit Office.
186. The developing work of the NAO in supporting various committees of Parliament is noteworthy. It has, by agreement, worked with, for example, the Treasury and Civil Service Committee, the Environment, Transport and Regional Affairs Committee, and the Public Administration Select Committee and is involved in supporting the Scrutiny Unit of the House of Commons.¹⁷⁶ Clearly such partnership increases the effective capacity of parliamentary committees as a whole, and such partnership is therefore to be welcomed. Its development could play an important role in improving the capacity of select committees to hold regulators to account effectively.
187. However, resources include not only expert assistance but also time. Time, in parliamentary terms, is a precious commodity. Members of Committees have many other responsibilities and the time available to meet necessarily limits what a Committee can do. Those other responsibilities – primarily parliamentary and constituency activities – are, as the volume of correspondence indicates, growing. A Committee will normally hold only one full meeting each week. MPs may be on other Committees and will often have other duties to attend to, including in the Chamber itself, at precisely

¹⁷³ Q 96, Vol.II p32; and Vol.II p25; Q1110, Vol.II p395

¹⁷⁴ Q98, Vol.II p32; Vol.II pp377-378, para 43

¹⁷⁵ Q909, Vol.II p321

¹⁷⁶ The NAO’s work with committees includes seconding NAO staff (one important, and regular, contribution of resources and expertise), providing memoranda on specific issues, and in the case of the Environment, Transport and Regional Affairs Committee, it resulted in an NAO report, *The Financial Analysis for the London Underground Public Private Partnerships* (HC54 2000-01), arising from the Committee’s recommendation in their 14th report of 1999-2000 (*Funding of London Underground*, HC411).

the time the select committee is sitting. Committees therefore have to be highly selective in their choice of inquiries. There is a tendency to go for policy inquiries at the expense of inquiries into expenditure and administration. Access to expert advice may have increased in recent years but so too has the complexity of policy making and the structure of governance.

188. Any study of a regulator or regulatory decision has to compete with a range of other issues commanding the attention of the relevant departmental committee. To engage in a regular review of regulatory bodies sponsored by a particular department would have a significant opportunity cost for a select committee. We fully understand, therefore, why scrutiny of regulators is occasional, lodging alongside a number of other important matters requiring the attention of the committees.

Consistency

189. The consistency of scrutiny relates to the regularity and ambit of that scrutiny. Regular ad hoc inquiries are not sufficient – valuable and necessary as those inquiries might be – to ensure comprehensive scrutiny which takes into account all of the activities of the regulator, or continuity of examination, in that focus on the key accountabilities of the regulators is maintained. Consistency reflects the aim of comprehensive and on-going scrutiny, supported by the necessary capacity to carry out effective inquiries with continuity.
190. The annual reports of the regulators, complemented by associated forward programmes and regulatory impact assessments provide a framework for consistent scrutiny. If annual reports are to be an on-going focus for consistent scrutiny, then it is a question for Parliament whether the contents of those reports should be more directed towards meeting the needs of parliamentary scrutiny. At present, the normal statutory requirement is for regulators to be required to prepare an annual report for Ministers (quite properly as part of the regulators’ accountability to the Ministers who appoint them, and to show how they have carried out their functions independently of Ministers), and for those reports to be laid by Ministers before Parliament, reflecting the hierarchy of accountability of independent regulators to Ministers and Parliament, and of Ministers to Parliament.¹⁷⁷
191. The annual report may be required to address different audiences as part of the regulators 360° accountability to interested parties already described. Different reports, albeit building on a common core relating to the activities of the regulator, might therefore be required. Select committees interested in consistency of scrutiny might therefore find it helpful to specify, and be engaged in, determining the form of the regular information reported to Parliament. Parliament could give consideration to how this might be effected.
192. Provision of relevant information is one side of achieving consistent scrutiny; the other side is continuity and focus in the members and committees carrying out that scrutiny. Responsive politics is an essential part of accountability to citizens, and the *ad hoc* select committee inquiry into an

¹⁷⁷ See Vol.II p 377, para 42: “Perhaps the most important mechanism by which regulators are held accountable for their performance is through their annual reports... in which they are required to detail their performance and activities in relation to their statutory duties.”

urgent regulatory issue plays an essential part, and must continue. We have received evidence that the House of Commons' select committees play this role well. However, as we have seen, there is the problem of ensuring that there is the time and expertise necessary in order to engage in regular scrutiny. We have heard that the political impetuses of select committees undermine consistent scrutiny. This, again, is understandable. There is a natural tendency to go for an immediate, and topical, issue – such as a particular regulatory failure – than there is to engage in regular, essentially low-key scrutiny of a regulatory body that is performing in an unexceptional manner. Another problem is that continuity of membership of House of Commons committees is hard to achieve. The lack of such continuity could impair the quality of scrutiny.

Co-ordination

193. We have referred to the need for co-ordination by the Government in creating a whole of Government view of regulation – a best practice requirement well set out by OECD in its recommendations to member states. Parliament, equally, should address the question of co-ordination in its scrutiny of regulators if it is to ensure the most effective use of its capacity. We have referred to the growing partnerships with the National Audit Office. The task for Parliament is to determine how to ensure co-ordination of a consistent, on-going programme of cost-effective scrutiny might best be achieved, budgeted for, and resourced, without limiting the discretion for necessary ad hoc inquiries as and when required. The two exercises would, we believe, complement one another: a committee's knowledge of the wider context of on-going regulatory scrutiny would make for more informed scrutiny of particular decisions.
194. Co-ordination is an important dimension and parallels our view of what should happen in Government. The need for central institutions of Government to facilitate and promote the development of good regulation and harmonised practice, and our recommendation that the roles of the Cabinet Office, the Treasury, the DTI, the Prime Minister's Office and the NAO be clarified in this regard, has implications for parliamentary scrutiny of these overall centralised functions. The Cabinet Office, with its key functions related to supporting the Better Regulation Task Force, and to control through the Regulatory Impact Unit (in particular relating to the requirements on departments and regulators for, and quality control of, RIAs) is scrutinised by a number of select committees from time to time, but lacks a focused regulatory counterpart in Parliament. We believe that there should be a counterpart.

Enhancing parliamentary scrutiny

195. We have heard evidence from a number of witnesses advocating greater parliamentary scrutiny of regulators. Some have put the case for a select committee in the House of Commons. (There is an interesting precedent in that one of the earliest examples of an effective thematic scrutiny committee was the Select Committee on Nationalised Industries.)¹⁷⁸ The argument for a Commons committee is that by virtue of being in the elected House it would

¹⁷⁸ See David Coombes, *The Member of Parliament and the Administration* (London: George Allen & Unwin, 1966)

have the standing and the public profile necessary for the task. A number of committees have undertaken inquiries into particular regulators or regulators and there is therefore some experience of engaging in such an exercise. The House of Commons has an extensive infrastructure of select committees with interests in regulation. Callum McCarthy, (then Chairman and Chief Executive of the Gas and Electricity Markets Authority and now Chairman of the FSA) told us: “I think that inevitably we are going to be accountable to a large number of committees. There is of course one committee in the Commons...it looks at a number of regulators...I happen to believe that the trade and industry committee is a rather expert committee...I find that the argument for having a particular committee just looking at regulators is an argument which does need teasing through”.¹⁷⁹ Ann Robinson, the (then) Chairman of Energywatch, told us: “I would like a regulatory committee something like the PAC – something with real teeth that can carry out investigations ... I was actually quite attracted to [Clare Spottiswoode’s] arguments for it being in the House of Lords, from the point of view of objectivity. To be perfectly honest, however, put that way, I think that it probably ought to be in the House of Commons. I am more likely to get a bit more pressure put on various ministers if it is in the House of Commons”.¹⁸⁰

196. Some witnesses made the case for a dedicated committee in the House of Lords. The case for a dedicated committee of the House of Lords is that its more consensual method of dialogue and inquiry would be more suited to such an exercise. For example, Clare Spottiswoode, formerly the Director General of Gas Supply, argued that “Unlike in other spheres, there is no shareholder to hold the office to account, and no electoral process. There are a series of *ad hoc* select committee investigations and the NAO investigations, but there is no focal point for an institutional ownership of the effectiveness of the office ... there is a strong case for a specialist committee to provide this institutional ownership. It would be desirable for this to be a committee of the House of Lords, where members may have a professional background in the relevant areas, and where politics is less of a driver”.¹⁸¹ In that context, it is worth recording that two of the regulators who gave evidence (Lord Currie and Baroness Young of Old Scone) are members of the House; some Peers are also members of the Boards of regulators. The House also offers greater opportunities for continuity of membership. Though membership of a departmental select committee in the Commons is for the lifetime of a Parliament, there is a substantial turnover as members leave to take up other positions, such as a ministerial post or to serve as a parliamentary private secretary. There are less incentives to leave for members of Lords’ committees and members normally serve their normal period under the rotation rule. The creation of a Lords’ committee on regulation would, it is argued, create a complementary balance to the work of the Commons’ select committees.
197. There is a third possibility, which is to establish a joint committee of both Houses. This would enable skills of members of both Houses to be utilised and would avoid any element of duplication and any proprietary claim that the scrutiny of regulation should rest with a particular House. It would enable the results of scrutiny to be reported directly to both Houses at the

¹⁷⁹ Q551, Vol.II pp193-194

¹⁸⁰ Q487 and Q492, Vol.II pp 157-158

¹⁸¹ Vol.II pp139-140, paras 25 and 33

same time. There has been a growing tendency to utilise joint committees for the scrutiny of draft bills – as on the Communications Bill, Mental Health Incapacity Bill and the Civil Contingencies Bill – and the work of these committees has generally been seen to be effective. There is also a permanent Joint Committee on Human Rights, which is now well established and operating with expert support. It offers a good example of how a joint committee can draw on the expertise of MPs and peers and exert influence on Government. The UK mobile operators said that there should be in Parliament “some kind of joint committee that looks at that issue in a more single-minded way and in a converged way”.¹⁸² For their part, The Electricity Association argued that “All utility regulation is complex and difficult, and, in view of the economic and social significance of these industries, it is important that there should be some focused and co-ordinated mechanism, preferably at parliamentary level, for assessing effectiveness in the round. This is a task that could be taken forward by the new cross-sectoral select committee. It might be possible to achieve this through a select committee for regulatory accountability, dedicated to the purpose and with a specific remit from Parliament to monitor the interface between Government and regulatory practice ... We would expect the existing layers of oversight to be rationalised and reduced by this new committee’s role”.¹⁸³ Establishing a joint committee, it could be argued, would enable both Houses to have ownership of the scrutiny of the regulatory state.

198. We are persuaded of the case for a committee to be created and for it to be a joint committee of both Houses. We believe that a joint committee will avoid the problems identified with a dedicated committee in either House and enable the skills of members of both Houses to be utilised effectively. Setting up such a committee is, we recognise, not problem free. The biggest problem is one of resources. Parliamentarians have limited time and in most cases will not themselves be specialists in regulation. It is essential, though, that the committee is furnished with sufficient expert staff and support to do its job effectively. Given the nature of regulation, this may entail the recruitment of a small number of specialists in the field. Providing such resources will add, though not dramatically, to the cost of Parliament, but the cost will be modest in relation to the likely returns.
199. **A dedicated parliamentary committee should be established to scrutinise the regulatory state.**
200. **This should preferably be a joint committee of both Houses and should be given the necessary resources to fulfil its task effectively.**
201. In our view, the functions of the joint committee should include the right to be consulted over any proposal to confer statutory powers on a new regulator, or to add to those of an existing regulator, in good time for its comments to be taken into account during pre-legislative scrutiny. Other functions should include:
 - Having regard to such issues as potential duplication or overlap of regulatory activities, and the clarity of hierarchies of objectives, paying specific attention to the development and maintenance of a ‘whole of Government’ view of regulation;

¹⁸² Q1169, Vol.II p437

¹⁸³ Vol.II pp165-166, paras 24, 33 and 34

- Identifying and promoting good practice in its role as the parliamentary counterpart of the lead Government department and the Regulatory Impact Unit of the Cabinet Office;
 - Examining whether regulation is guided by the OECD check list and the BRTF principles (as recommended in this report);
 - Satisfying itself that appointment processes for regulators conform to Nolan principles;
 - Monitoring the regularity and scope of RIAs produced by Government and by independent regulators;
 - Focusing on annual reports of regulatory bodies with a view to maintaining the consistency and co-ordination of parliamentary scrutiny.
202. We see this as complementary to rather than as a substitute for the work of the departmental select committees of Parliament. They would continue to monitor the activities of those regulators within their respective purviews, but **we recommend that they consider expanding their terms of reference to include a requirement routinely to consider and react to regulators' annual reports, and monitor the use of resources. These activities would be in addition to the *ad hoc* inquiries they undertake from time to time.**
203. **For parliamentary scrutiny by select committees to be more consistent and co-ordinated, it should be focused around the annual report and the published RIAs, and with specific attention paid to a harmonised whole of Government view of regulation.**

Consistent access by the National Audit Office to regulatory bodies

204. The evidence we have received has shown that regulators come in various corporate shapes and sizes. These include:
- ministerial Government departments;
 - non-ministerial public departments (NMPDs);
 - executive non-departmental public bodies (NDPBs);
 - statutory corporations (public);
 - companies limited by guarantee (private companies).
205. We have noted that these have arisen for a variety of reasons, and that the form chosen may affect the relationship with Ministers and the degree of regulatory independence.¹⁸⁴ These structures are more to do with questions of design of an effective regulatory framework than with regulatory accountability. Each should be equally accountable for their regulatory and other associated public functions.
206. The National Audit Office's traditional role has been to audit and supply Parliament, under privilege, with an opinion on the appropriation accounts. This role focuses on the accountability of the accounting officers, most

¹⁸⁴ The institutional arrangements are referred to in paragraph 17 of the DTI written evidence (Vol. II p374): "the majority of regulators are non-ministerial government departments, have a separate vote with HM Treasury and are financed by licencees".

notably of the ministerial and non-ministerial departments of state. The NAO role has expanded over time to encompass a wider form of audit and inquiry (value for money studies), and since the Sharman report to HM Treasury (2001), non-departmental public bodies that did not fall within the purview of the NAO are progressively being included (albeit that the NAO may still contract out the audit), so that the NAO can follow public money more effectively through the decentralised forms of state organisation ever more in place (even if still more or less centrally controlled).¹⁸⁵ The National Audit has traditionally been excluded from the audit of public corporations and the nationalised industries.

207. The NAO has developed its work on regulators in recent years - which from the evidence has been generally well-regarded,¹⁸⁶ and we find it anomalous that the NAO does not have unqualified access to all of the economic regulators. The FSA, Ofcom and the CAA differ from the other regulators in that the FSA is a company limited by guarantee and Ofcom and the CAA are public corporations. Nevertheless, the Communications Act 2003 has granted the NAO access to Ofcom which will therefore be subject to its scrutiny. The Financial Services and Markets Act 2000, however, statutorily disbarred the NAO from access, leaving it to the Treasury to decide as and when a review was required, and what form it should take. Whilst it could be said that the CAA is simply an historical anomaly because it was established as a public corporation in a different era - 1972 - with regard to the NAO's role, the position with respect to the FSA has to be considered as a surprising exclusion, given the changed role and expectations of the NAO in relation to the effectiveness of parliamentary scrutiny.
208. These matters were debated during the Financial Services Bill, but two aspects seem relevant to us now. First, Parliament's role in holding regulators to account needs to be made more effective, and consistent access by the NAO to regulatory bodies is required for that, both in principle and practice. Secondly, the FSA's accountability to those it regulates, and from whom it extracts fees to cover its expenditure, is a complement to, and not a substitute for, the FSA's full accountability to Parliament, which includes exposure to NAO scrutiny. Mr Stephen Timms told us that "There is a rather different arrangement in the case of the CAA, the FSA and Ofcom, which are not subject to NAO scrutiny, and the difference is that they are all funded through fees and charges. So there is no taxpayers' interest to be protected, as there is through the others. That mechanism will also mean that there is a strong voice on the part of those paying the fees for them to be maintained at as low a level as possible. One can see with CAA and I am sure it would be the case with Ofcom as well, that that will be quite an effective

¹⁸⁵ Report by Lord Sharman of Redlynch, Holding to Account - The Review of Audit and Accountability for Central Government (London: HM Treasury, 2001).

¹⁸⁶ But we have received critical views. See Professor Littlechild's written evidence (Vol.II p25): "As the number and regularity of the NAO reports have increased, they have gone beyond an 'audit' of what has happened, to (eg) an analysis of what kind of price controls might be most appropriate for the future. It is not clear that this is where the NAO's strength lies, or that it pushes forward regulatory thinking. There is also the danger that if the investigation became too frequent and routine it could lead to regulatory offices informally checking policy with NAO officials in the course of implementation in order to prevent criticism in a future report. This could blur accountability". See also Alex Henney, Director, EEE Ltd written evidence (Vol.III p95, paragraph 44): "In my view the NAO reports on Ofgem's activities do not fulfil the objectives of the Act of 'promoting economy, efficiency, and effectiveness'. Perhaps this should not be surprising because we should not expect too much of the civil service investigating the efficiency and effectiveness of the civil service, which is an oxymoron".

mechanism for accountability in terms of keeping costs as low as they can be".¹⁸⁷

209. The argument for this different treatment does not seem compelling, given, for example, Ofwat is equally fully funded from licence fees payable by the regulated companies. Consistency of access is the most important argument for reasons of accountability.
210. The NAO's evidence is compelling, at this time, referring particularly as it does to Lord Sharman's report, *Holding to Account, the Review of Audit and Accountability for Central Government* (February 2001).¹⁸⁸
211. Demands on parliamentary time means that such anomalies might not reasonably be rectified in the immediate future. However, the substantive outcome could be achieved in the interim. The Government should be asked to declare that it is its intention to give the statutory rights of access to the NAO to the CAA and the FSA as and when the next legislative opportunity arises, just as it has in stating that the CAA will be made an independent economic regulator along the lines of GEMA *et al.*¹⁸⁹ Given this intention, HM Treasury could declare under the current statutory arrangements that it will ask the NAO to advise it when to exercise its right to review the FSA (which it should accept, unless there is good reason, to be announced by the Minister in Parliament), and that having accepted that advice, the NAO should be asked to carry out that review, reporting to Parliament on the outcome in the normal way. The NAO could, as with current arrangements, contract out that review audit (whilst retaining supervisory responsibility) if specialist skills are required. There are precedents for such partnership work, as with NAO work for a number of parliamentary select committees, given that the Treasury is currently working with the DTI and the NAO to investigate the effectiveness of the independent consumer bodies. Another advantage of such an arrangement would be to clearly distinguish the internal control responsibilities of the Treasury in relation to the FSA from the public accountability of the FSA and Treasury Ministers to Parliament for the exercise of regulatory functions.
212. **We recommend therefore that the NAO have access consistently to all regulatory bodies, including the FSA, with a view to monitoring their cost-effectiveness and budgetary control.**

A regulatory forum

213. The commitment of Governments to a whole of Government view of regulation requires political endorsement at the highest level, and the authority to co-ordinate and develop best practice among departments. This requires that the institutional arrangements for design and co-ordination of effective regulation should be held by a central department. This suggests that the Cabinet Office, with its closeness to the Prime Minister's Office, should be given explicit supervisory responsibility, and be properly resourced to achieve that.

¹⁸⁷ Q1104, Vol.II p394

¹⁸⁸ Vol.III p119, paras 14, 15 and 16

¹⁸⁹ See A Fair Deal for Consumers: Modernising the Framework of Utility Regulation - response to consultation (London: Department of Trade & Industry, 1998)

214. The DTI submitted evidence to us that it was responsible for co-ordination of economic regulation. The DTI, however, sponsors particular regulators and there could be conflicts of interest between promoting harmonised models of regulation and arguing for special cases with respect to their interests. The DTI is also responsible for consumer affairs. Clearer separation of roles and responsibilities should both improve the design and practice of regulation by Government and the accountability for that regulation to Parliament.
215. The BRTF made a recommendation in its recent report on independent regulators that better co-ordination and harmonisation would be achieved if there was a regulatory forum for regulators. The idea is a good one and builds on the joint regulators meetings which have developed, particularly since the Green Paper on regulatory reform.¹⁹⁰ However, we have received evidence that these are less effective than they might be. “A joint economic regulators group also exists. It produces a thin and inadequate annual report. It does not publish agendas or minutes. Government appears to think it should have a role in agreeing best regulatory practice, but it does not discharge this role very effectively, and only a few reports have appeared so far. Water UK believes that recommendations for improving the accountability of this group should be developed by the inquiry”.¹⁹¹
216. The BRTF has suggested that the NAO be invited to chair such a forum. We believe that this might confuse roles and compromise the clearly perceived independence of the NAO to scrutinise regulators. There must be no hint of a conflict of interest for the NAO, were the forum to develop in such a way that the NAO was seen to be involved in prospective regulatory actions rather than giving independent effect to accountability by offering its remedies and advice retrospectively. We believe it is more appropriate for the Cabinet Office itself to promote the forum and to provide the necessary leadership role, through the chairmanship. There is also a case for providing an on-going secretariat function to joint regulatory groups. Given regulators are independent within, rather than of, the state, this should not compromise independence but provide an important consistency, and promote harmonisation which might be lacking in the present arrangements.
217. The role of the National Audit Office in carrying out independent scrutiny of regulatory impact assessments both before and after the event is to be encouraged, and the NAO evidence shows that the Government supports this process of scrutiny. “We have more generally examined the way that central Government assesses new regulatory proposals through the use of regulatory impact assessments. Our report provided policy makers with good practice examples, and a checklist of what assessments should cover. Following a recommendation by the Committee of Public Accounts, the Government have given the National Audit Office an on-going role in examining individual assessments and reporting annually on the lessons to be learned.”¹⁹²

¹⁹⁰ “The regulators themselves have initiated ‘joint working’ arrangements to promote best practice and discuss issues of common interest – the heads of the regulatory bodies meet bi-monthly, and there are also working level meetings to discuss specific issues” (DTI written evidence: Vol.II p378, para 45)

¹⁹¹ Vol.II p106, para 20.

¹⁹² NAO press notice *Regulatory Impact Assessments – the NAO’s new role*, 2 December 2002. See also Vol.III p118, para 10.

218. **We welcome this expansion of the role of the NAO and recommend that the annual review of Regulatory Impact Assessments by the NAO be developed. In order to maintain the strict independence of the NAO and its scrutiny role, we recommend that this should not be undertaken as an agency of the Cabinet Office. These RIAs need to be conducted retrospectively as well as in advance, to ensure that cost-effectiveness is constantly under review.**

CHAPTER 11: IMPROVING THE APPEALS MECHANISMS

219. Challenge constitutes the most powerful form of accountability. The courts may overturn the decision of a regulator. Public bodies are subject to judicial review. Decisions of certain regulators may also be challenged on the merits of the case.
220. In addition to judicial review, both the Competition Commission and the Competition Appeal Tribunal have roles in reviewing regulatory decisions. Where the regulator of a privatised utility seeks to modify a condition of licence, which modification is not accepted by a licence holder, the regulator must refer the matter to the Competition Commission which can propose its own modifications. This is in effect an appeal in all but name.¹⁹³ The Competition Appeal Tribunal, which operates under the Competition Act 1998 and the Enterprise Act 2002, hears appeals on the merits from the decisions of the Office of Fair Trading and sectoral regulators in relation to agreements restricting competition and to abuses of a dominant position in the market.¹⁹⁴ The Competition Appeal Tribunal also hears appeals by way of judicial review only in relation to merger and market investigations.¹⁹⁵ Apart from a few specified decisions of certain regulators, the above are the only situations where appeals on the merits are presently competent.
221. We have noted already the problems with judicial review. Appeal to the courts is a powerful weapon. The prospect of it may serve as a deterrent to regulators. It can certainly be argued that it ensures that they are rigorous in their attachment to due process in the reaching of decisions. Nonetheless, taking a case to judicial review is expensive and time-consuming. Delay can result in regulatory drift. For those who are regulated, seeking judicial review may create more problems than the one they seek to resolve by taking such action. For many, therefore, judicial review is not a viable option. It is also, as we have noted previously, essentially a negative weapon and one that is narrow in focus. The test of unreasonableness is a difficult one to meet. There are, as we have just recorded, few other means of challenging a decision of a regulator.
222. There is thus a *prima facie* case for considering looking at the appeals process to see if it can be simplified and better access afforded to those affected by regulation. In undertaking such a study, one has to balance the rights of the regulated and other affected parties and the problems that may be caused by excessive recourse to the courts or other statutory appeals bodies, especially when undertaken as part of a game-playing exercise or to undermine the effectiveness of the regulatory authority.
223. Some think the current balance is about right. Stephen Timms, Minister of State at the DTI, told us that “On the whole I think the balance is now about right and the arrangements are working pretty well”.¹⁹⁶ Tom Winsor told us that he thought “Network Rail have all the appeal rights that they need”.¹⁹⁷

¹⁹³ Vol.II p180, para 20: Vol.II p351, para 13

¹⁹⁴ QQ1005-7, Vol.II p355

¹⁹⁵ QQ1009-12, Vol.II p356

¹⁹⁶ Q1119, Vol.II p398

¹⁹⁷ Q616, Vol.II p224

224. There are those who think there should be greater rights of appeal. According to Professor Prosser, “The safest course is to provide a full right of appeal on the merits whenever a regulatory decision may have substantial consequences for a regulated enterprise”.¹⁹⁸ Royal Mail told us that lack of appropriate appeal mechanisms meant more confrontation in the regulatory relationship.¹⁹⁹ The Electricity Association, noting the development of the Competition Appeal Tribunal, suggested that the answer would be a comprehensive ‘new animal’, a regulatory appeals tribunal.²⁰⁰ Professor Prosser supported an enhanced role for the Competition Appeal Tribunal²⁰¹ though his views were questioned by the Competition Commission, which suggested that its expertise and resources made it a suitable focus for any fast track appeals.²⁰²
225. There are those who suggest that change is coming anyway. Professor Prosser advised us that judicial review is developing towards taking account of the merits.²⁰³ The Communications Act 2003 has set a generic precedent of appeals on the merits (substance) of the case to an independent tribunal.²⁰⁴ Management of the appeals mechanism therefore becomes the important issue. Sir Christopher Bellamy told us that “We would strike out frivolous appeals in a summary way if that became a problem”.²⁰⁵
226. The situation is a dynamic one. There are various developments internationally that have a bearing, not least in the European Union, as well as nationally. There is the relative newness of ‘super complaints’. There is a review of the appeals process by the DTI and a growing trend towards granting greater appeal rights.
227. These developments could form the basis of arguing that there should be a pause until the picture becomes clearer. We reach the opposite conclusion. The present situation is not static and as such creates uncertainties for the regulated and those affected by the actions of regulators. We believe that there should be greater coherence. We blend principle with practice in contending that there should be a move towards allowing appeals based on the merits of the case. We believe that this right should be introduced over time and accorded to all those who are subject to regulation, subject to the right of the appeals body to reject, and penalise those responsible for, unwarranted appeals.
228. We have looked at fast track appeals and we have benefited considerably from the evidence given to us by the Competition Appeal Tribunal and the Competition Commission. We have been impressed by the way in which such procedures presently operate, appeals being dealt with expeditiously. Such expeditious treatment not only reduces the financial cost but also limits the prospect of regulatory uncertainty.

¹⁹⁸ Vol.II p53

¹⁹⁹ Q641, Vol.II p233

²⁰⁰ Q501, Vol.II p171

²⁰¹ Vol.II p 60

²⁰² Vol.II p326, para 11

²⁰³ Vol.II p51, para 2

²⁰⁴ Vol.II pp352-353, paras 20 and 35

²⁰⁵ Q1025, Vol.II p357

229. We believe that fast track appeals on specific issues and other arbitration mechanisms should be developed, contingent on the approval of the appeals body, where there is opposition from one of the parties. We welcome the Competition Commission's willingness to play a part in this process.²⁰⁶ However, the Commission and the Competition Appeal Tribunal do not cover all independent regulators. We therefore find persuasive the argument advanced by the Electricity Association that a Regulatory Appeals Tribunal be created, though we would see this as appropriate only for those regulators not presently covered by the Competition Commission or the Competition Appeal Tribunal. The effect would be to ensure that coverage of the regulatory state was comprehensive, enabling appeal on the merits of the case.
230. **Appeals should provide an opportunity for the regulated to have their objections reviewed on the merits of the case, subject only to the condition that the appeal body should have the clear ability and power to identify and penalise appeals designed to frustrate equitable regulation.**
231. **Simplified systems of fast track appeals and arbitration should be developed for decisions by the Competition Commission and the Competition Appeal Tribunal and made available subject to the agreement of each of the parties concerned.**
232. **We further recommend that a Regulatory Appeals Tribunal should be set up to cover regulatory decisions that do not fall within the jurisdiction of either the Competition Commission or the Competition Appeal Tribunal, with a similar provision for fast track appeals and arbitration.**

²⁰⁶ Q919, Vol.II p322-323; and Vol.II p314, para 17

APPENDIX 1: SELECT COMMITTEE ON THE CONSTITUTION

The members of the Committee which conducted this inquiry were:

Lord Acton

Lord Elton

Lord Fellowes

Baroness Gould of Potternewton

Lord Holme of Cheltenham

Baroness Howells of St Davids

Lord Jauncey of Tullichettle

Lord Lang of Monkton

Lord MacGregor of Pulham Market

Earl of Mar and Kellie

Lord Morgan

Lord Norton of Louth (Chairman)

Peter Vass, Director of the Centre for the study of Regulated Industries (CRI), University of Bath School of Management, was appointed as Specialist Adviser for the inquiry.

Declarations of Interest:

Lord Elton

Chairman, Financial Intermediaries Managers & Brokers Regulatory Association, 1987-90

Lord Fellowes

Chairman of a Water Treatment Company (subject to regulation by Ofwat).

Baroness Gould of Potternewton

Member of ICSTIS (Independent Committee for the Supervision of Standards of Telephone Information Services) (Independent Regulator)

Lord Lang of Monkton

Director of a number of public companies, as per the Register of Lords' Interests, some of which are regulated by the Financial Services Authority

Lord Macgregor of Pulham Market

Remunerated Directorships

European Supervisory Board, DAF Netherlands plc

Non-executive Director, Associated British Foods plc

Non-executive Director, Friends Provident plc

Non-executive Director, Slough Estates plc

Non-executive Director, Uniq plc

Other

Trustee, Conservative and Unionist Agents' Superannuation Fund

Trustee, West Buckland School Foundation

Joint Deputy Chairman, Association of Governing Bodies of Independent Schools

Member, Committee on Standards in Public Life

Council, Institute of Directors

APPENDIX 2: CALL FOR EVIDENCE

The Constitution Committee have been appointed “to examine the constitutional implications of all public bills coming before the House; and to keep under review the operation of the constitution”.

The Committee have decided to conduct an inquiry into the workings of regulators, and in particular:

“The accountability of Government-appointed regulators, their scrutiny by Parliament, their accessibility to the public, and their responsibility to the citizen”.

The inquiry will focus primarily on the regulators of utilities, the media, and the financial and service sectors. At least initially, ombudsmen and executive agencies with regulatory functions will be only a secondary consideration, although the Committee welcome written submissions from such bodies.

The Committee welcome written submissions which address any or all of the following:

Background

- (1) What forms of co-operation between EU Member States on external border controls already exist, and what are their strengths and weaknesses?
- (2) What are the legal bases for regulators; what is the nature of their powers and how do they exercise them; how could their powers be revoked; from where do they obtain their financial and administrative support?
- (3) By whom and how is the continuing need for regulators measured; how is their role changed or ended?
- (4) Who are the members of regulatory bodies; how are they appointed; are they adequately representative; do Nolan principles operate?
- (5) What are regulators set up to achieve; to what extent do regulators achieve their purposes without adverse consequences; how is their effectiveness assessed?
- (6) To what extent are regulators both prosecutors and juries on an issue; what rights of appeal are there against decisions made by regulators?

Accountability

- (7) How are regulators held to account by Parliament; what other accountability do regulators have to auditors, Government departments or other public bodies?
- (8) How are regulators accountable to those whom they regulate; what is the impact of regulation on the economy; how transparent are their methods of working?
- (9) How are regulators accountable to the public other than through Parliament; what opportunities do the public have to express particular concerns to regulators; how do regulatory bodies relate to their associated consumer watch-dogs?

- (10) How effective is public consultation by regulators; what opportunities do the public have to contribute; to what extent do the public make use of those opportunities?
- (11) To what extent do the needs or concerns of the public guide the work of regulators; are regulators instruments of Government or representatives of the public?
- (12) How independent are regulators of Government; what factors do or might compromise their independence

APPENDIX 3: LIST OF WITNESSES

The following witnesses gave evidence. Those marked with * also gave oral evidence and their submissions can be found in Volume II (HL Paper 68-II). Other evidence is published in Volume III (HL Paper 68-III).

- Air Transport Users Council (ATUC)
- Association for Financial Services Professionals (LIA)
- Association of Electricity Producers
- * Association of Independent Financial Advisers (AIFA)
- Association of Train Operating Companies (ATOC)
- Audit Commission
- Baigrie, T Q
- Bennett & Co, Paul
- Blackmore, John
- British Air Transport Association (BATA)
- British Airports Authority Plc (BAA)
- British Airways (BA)
- British and Irish Ombudsman Association
- British Energy Plc
- Broadcasting Standards Commission
- Brown, Richard
- Burnard, John
- * Byatt, Sir Ian
- * Carsberg, Sir Bryan
- * Civil Aviation Authority (CAA)²⁰⁷
- Communication Workers Union
- Complaints Commissioner
- * Competition Commission
- * Competition Appeal Tribunal
- Consumers' Association
- Cowsill, Eric
- Creyke, George R
- Crowley, Bill
- Dracup, Peter
- Ellam, Peter
- * Electricity Association
- * Energywatch
- * Environment Agency
- European Policy Forum
- Evans, Peter
- Evans & Associates, Philip
- * Financial Services Authority (FSA)
- * Financial Services Consumer Panel (FSCP)
- * Financial Services Practitioner Panel FSPP)

²⁰⁷ CAA's evidence in response evidence from BA is printed in Volume III

- ★ Foster, Sir Christopher
Freeserve.com plc
- ★ Gas Forum
Gerrard, Neil
General Teaching Council for England (GTC)
Greenslade, Neal
Griffiths-Buchanan, Peter
Hansard Society
Health and Safety Executive (HSE)
Henney, Alex (EEE Ltd)
Henney Alex (EMAG)
Independent Television Commission (ITC)
Innogy Plc
King, Susan
Lang, John M
Laugier, Claude
Lentz, Brian
Lloyd's Names Association and Names for Action for Compensation
and Defence in Europe
- ★ Littlechild, Professor Stephen
Mansell, Simon
Matthews, W
National Audit Office
- ★ National Consumer Council (NCC)
National Lottery Commission
Names' Action for Compensation and Defence in Europe
Northern Ireland Ombudsman
Northumbrian Water Limited
Nursing and Midwifery Council
- ★ Office of Telecommunications (Of tel)²⁰⁸
Office for Standards in Education (Ofsted)
- ★ Office of Communications (Ofcom)
- ★ Office of Fair Trading (OFT)
- ★ Office of the Gas and Electricity Markets (Ofgem)
Office of the Pensions Ombudsman
- ★ Office of the Rail Regulator (ORR)
- ★ Office of Water Services (Ofwat)
Pett, Stephen
- ★ Postcomm (Postal Services Commission)
- ★ Postwatch
- ★ Prosser, Professor Tony
Pritchard, Alan

²⁰⁸ Ofcom inherited the duties of the five regulators, four of which submitted evidence: the Broadcasting Standards Commission; the Independent Television Commission; Of tel; and the Radio Authority. Their evidence is printed with oral evidence from Ofcom in Volume II.

- Qualifications and Curriculum Authority (QCA)
- ★ Radio Authority
- ★ Royal Mail Group Plc
- Rushworth, Desmond
- Scottish Environment Protection Agency (SEPA)
- Scottish and Southern Energy Plc
- ★ Spottiswoode, Clare
- Stansfield, Geoffrey
- ★ Swift, John
- ★ Thatcher, Dr Mark
- Treasury, HM²⁰⁹
- ★ Trade and Industry, Department of²¹⁰
- TotalFinaElf Gas and Power Limited
- Tudor House Financial Services
- UK Mobile Operators²¹¹
- United Utilities²¹²
- ★ Vass, Peter
- ★ WaterVoice
- ★ Water UK
- West, Dr Julian
- Woodall, Jonathan
- Work and Pensions, Department of
- Anonymous
- Anonymous
- Anonymous

The following evidence has not been printed, but is available for inspection at the House of Lords Record Office (020 7219 5314)

Berg, Jodi
 Brown, Professor Alice
 Clancy, Michael
 Dolan, Frank
 Field Fisher Waterhouse
 Flinders, Dr Matthew
 Freethecartwright
 Gillespie, Robert
 Hughes, Professor T G
 Jonker, Mr A
 King Associates
 Stratford, Frank L

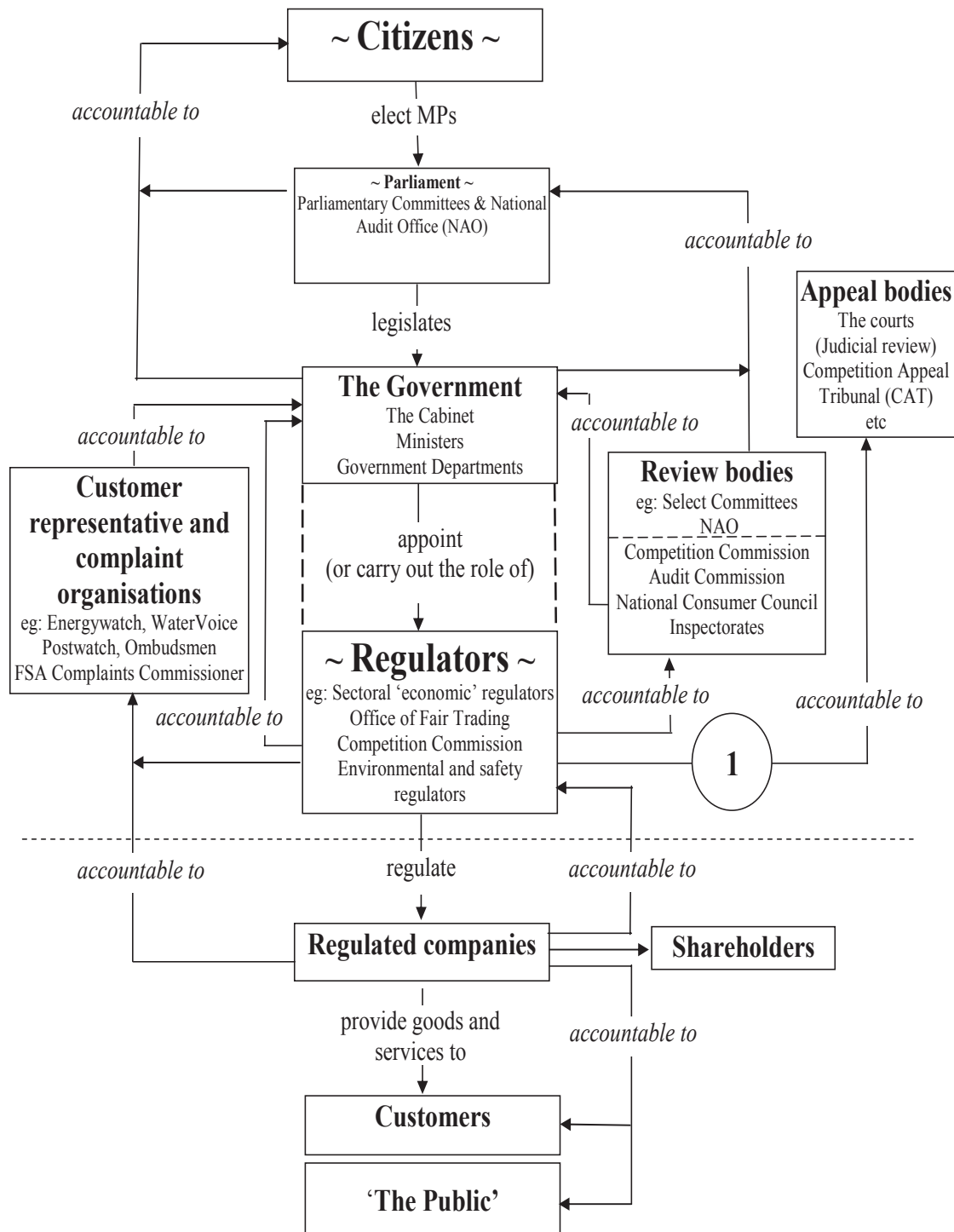
²⁰⁹ HMT's evidence in relation to the FSA is printed in Volume II

²¹⁰ DTT's evidence in relation to the OFT is printed in Volume III

²¹¹ Printed with oral evidence from Mobile Broadband Group in Volume II

²¹² United Utilities evidence is printed with evidence from Water UK (Dr Clive Elphick) in Volume III

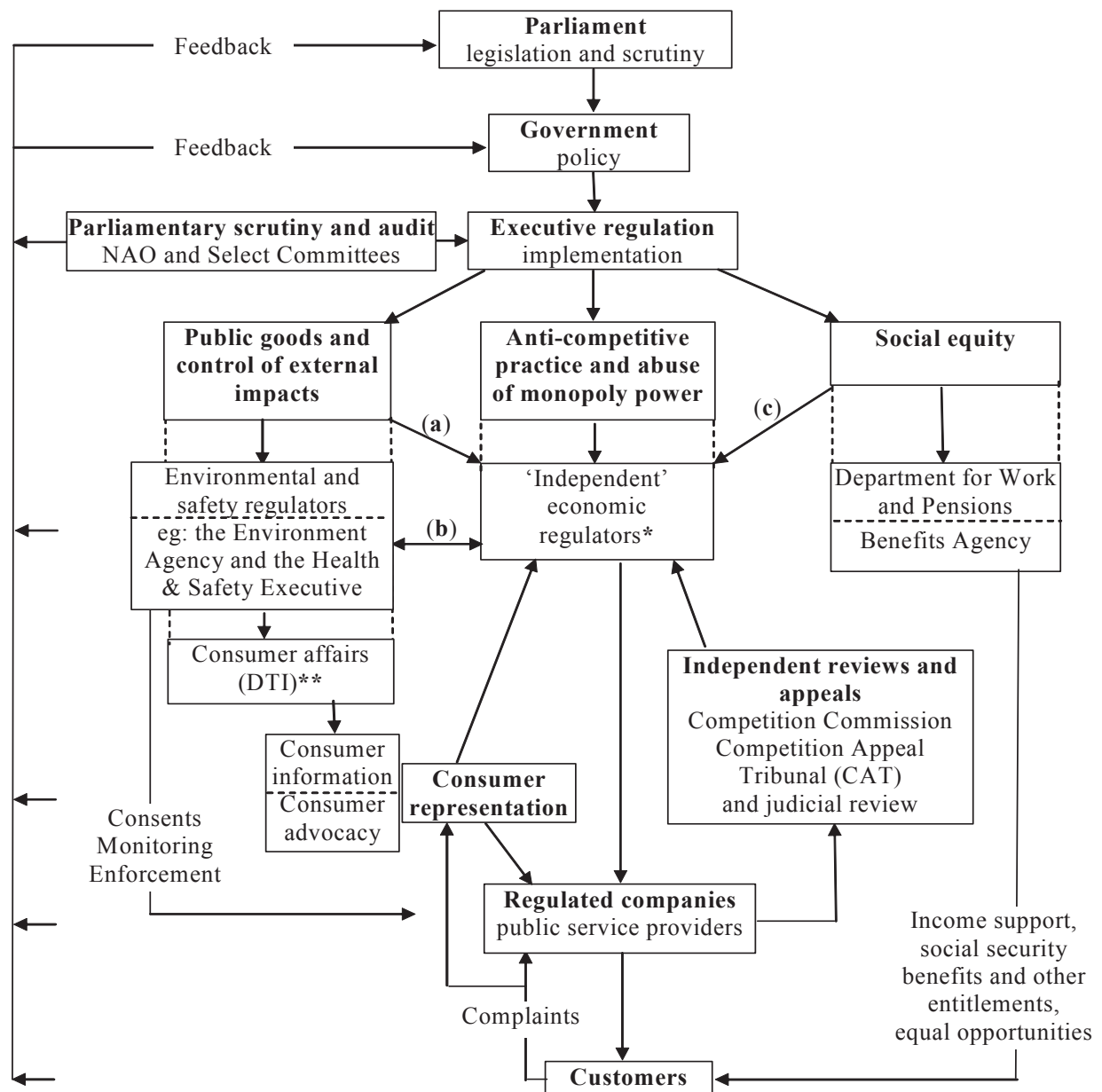
APPENDIX 4: THE ACCOUNTABILITY OF REGULATORS TO CITIZENS AND PARLIAMENT



1

Note that the accountability lines in the diagram focus in each case on one or more of the three elements of accountability in practice: a) the duty to explain; b) exposure to scrutiny and c) the possibility of independent review. The accountability of regulators to the regulated companies is given formal effect by statutory duties on regulators to give reasons for decisions and to consult, and by the possibility for the companies to challenge the regulators' decisions, either through the courts or by other appeal mechanisms.

APPENDIX 5: THE REGULATORY FRAMEWORK

**Notes:**

(a) reflecting the devolution of responsibility for setting certain public good standards, such as reliability and security of supply, to the sectoral 'economic regulators' (accompanied where relevant by ministerial 'guidance').

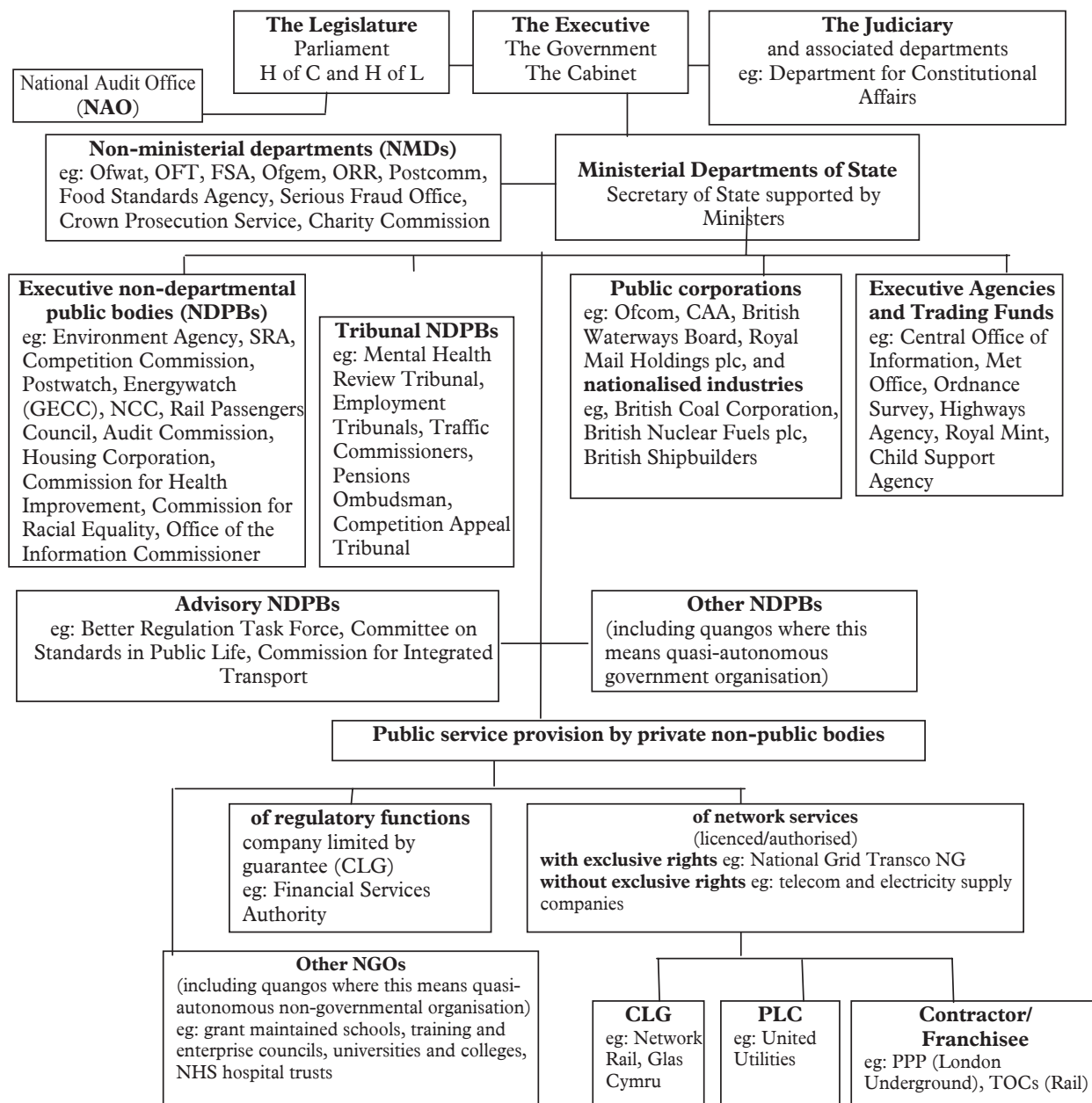
(b) reflecting inter-regulatory dialogue, the requirements of the BRTF good regulation principles, and cost-benefit tests when setting standards.

(c) reflecting the impact of 'social action' plans required of economic regulators by government by way of ministerial 'guidance'.

* sectoral economic regulators of water, energy, transport and communications, such as Ofwat, Ofcom, Ofgem, CAA, ORR and SRA; national competition authorities, such as the Office of Fair Trading (OFT) and the Competition Commission; other prudential and market regulators, such as the Financial Services Authority (FSA) and the Occupational Pensions Regulatory Authority (Opra).

** delivery of consumer policy involves (and will be influenced by) bodies such as the National Consumer Council (a public body), the Consumers' Association (CA) and the National Association of Citizens Advice Bureaux (NACAB), and sectoral bodies such as Energywatch and WaterVoice. Internationally, for example, there is the European Consumers' Organisation (BEUC).

APPENDIX 6: PUBLIC BODIES AND THE REGULATORY STATE



Notes:

Executive Agencies followed Sir Robin Ibbs' 'Next Steps' report (1988), and NDPBs followed Sir Leo Pliatzky's report on Non-departmental Public Bodies, cmd 7797 (1980).

The Cabinet Office's publication, Public Bodies (latest edition 2003), focuses on NDPBs, Advisory NDPBs, Tribunal NDPBs, Public Corporations and other NDPBs. This is a restricted coverage as a comprehensive coverage of public bodies in general would include, for example, Executive Agencies, Non-Ministerial Departments and Trading Funds.

APPENDIX 7: COMMITTEE VISIT

Summary of evidence taken by the Committee in Brussels Wednesday, 29 October 2003

Meeting with Mr. Jürgen TIEDJE, DG “Internal Market”

Mr Tiedje is Secretary of the European Securities Committee and desk officer for the “Transparency Directive” under the Lamfalussy procedure. He has worked on Securities markets in DG Internal Market since September 2001 and has worked in the Commission for 11 years.

Financial Services Action Plan (FSAP)

As part of the Lisbon agenda to make the EU the most competitive economy in the world by 2010, it had been agreed by the Council that the FSAP would be completed by 2005. Cross-border trade in equities had increased by 25% each year from 1996 to 2001. The need for a single market in financial services had become even more important with the introduction of the Euro.

Of the 42 initiatives of the FSAP, 38 had been completed, and the remainder should be completed by April 2004. The deadline for implementation was 2005. This was very rapid, especially compared to an earlier series of financial measures which had been discussed throughout the 1990s without reaching a conclusion.

This progress was partly a result of the Lamfalussy procedure: first the Council agreed a policy; second the Commission worked out the technical details under the comitology process; third the measure was implemented consistently through the Council of European Securities Regulators (CESR); and finally the measure was enforced. The third stage was still in embryonic form and the fourth was not yet developed. The first directive needed to be implemented by October 2004.

The Commission prepared a formal draft directive only once it had obtained technical advice from CESR—the Financial Services Authority (FSA) was the UK member. A qualified majority of National Ministry Supervisory Authorities (the Treasury for the UK) was then needed to adopt the draft. (The European Parliament was only consulted during this process. It had asked for the same rights as the Council, but this had been refused. The current system was, however, due for renegotiation in 2007.) The directives thus balanced the views of the regulators (whose role was to defend investors and market participants) with the views of the national ministries.

Consultation

Mr Tiedje said that the Commission consulted extensively. They had issued written consultations and held hearings for both the Investment Services Directive and the Transparency Directive. Consultation helped the Commission to identify the main issues and resulted in a gain in time later in the process. However, market participants often under-estimated the tight deadlines to which the Commission was working.

Mr Tiedje agreed that there was no real consultation of small retail investors as opposed to institutional investors. His unit was setting up groups of experts, but consumer representation was hard to achieve as they tended to have no expert knowledge and their demands were often unrealistic. He commended the FSA’s system of industry and consumer consultative panels.

In response to the claim that the Commission was trying to do too much too quickly, Mr Tiedje reaffirmed the improvement in consultation procedures, for example by consulting

industry experts before a consultation paper was issued. The amount of consultation was driven by the FSAP deadline of 2005—consultation was expected to reduce thereafter.

Regulatory Impact Assessments (RIAs)

RIAs, both *ex ante* and *ex post* were becoming systematic. The call for cost-benefit analysis of regulatory decisions was coming from the UK, but this would be difficult and expensive to do over 25 Member States—were it to be required it would paralyse the Commission. Assessing costs relied on information from market participants

Subsidiarity

The Commission looked for maximum harmonisation in some areas, such as the use of International Accounting Standards (which had been asked for by industry) and the Prospectus directive, which would ensure the automatic mutual recognition of prospectuses. In other areas the Commission sought minimum harmonisation: rules to prevent market manipulation and insider dealing were set by the Commission, but methods of implementation and enforcement were left to Member States.

Accountability

The Commission was ultimately responsible to the European Parliament and the Council, although Member States were accountable for the implementation of directives.

CESR used peer pressure to enforce implementation of directives, which could ultimately be enforced by the Commission. However, the Commission relied on joint working with CESR and Member States to police implementation. Of the complaints received, about 5–10% went to court and the Commission won 90% of cases. With enlargement, however, it was becoming more important not to win cases but to avoid them by increasing co-operation with CESR and Member States.

Consumers did not have direct right of challenge but could complain via the national regulator (the FSA for the UK) to bring matters to the Commission's attention.

National Regulatory Authorities

In the UK, as in Germany, Austria and Ireland, the National regulator was unified (e.g. the FSA). In the Netherlands, however, they adopted a functional approach with one authority for banking, another for consumer protection and so forth. In 2001 there had been 40 regulators for 15 member states. The trend was now towards having one national regulator per member state. National regulators could engage better with CESR to improve the development and implementation of policy.

Meeting with Mr. Dominique RISTORI, Director, DG "Energy & Transport"

Mr Ristori is the Director responsible for General Affairs and Resources covering Financial Resources; Human resources, training and IT; Interinstitutional relations, enlargement and international relations; Internal market, public service, competition and user's rights, and Information and communication.

Competition policy in Energy and Transport

Mr Ristori noted that energy and transport were two public service sectors that directly affected citizens. Previously both sectors had been controlled by monopolies but a turning point had been reached (particularly in energy) with the introduction of liberalising directives which were part of the programme to complete the single market.

The Commission initiatives required to install a proper legal framework had to be complemented by other initiatives which sought to change mentalities and promote harmonisation, particularly through the use of regulatory forums. The European Council of Energy Regulators formed in 2000 was a case in point, building on twice yearly meetings in both electricity and gas since 1998. The European Association of Transmission Operators also played a vital role. The Barcelona European Council 2002 addressed the finalisation of the internal energy market, and had agreed to open the energy market completely by 2007.

In effect, the Commission was incorporating a competition policy for utilities and network industries which had been first developed most fully in the UK. In preparing for these initiatives, representatives of industry and consumers had played an important part in helping to decide on the requirements, and to identify whether new European laws were necessary. This process of engagement was vital to achieve accountability, legitimacy and consent.

Public service obligations and competition

Mr Ristori stated that there was no necessary connection between black-outs and liberalisation. Regulators were equally concerned with competition and security of supply; this needed to be explained to the public, given consequences such as improving cross-border planning, information flows and procedures, and reinforcement of grids. Equally, the Commission recognised a third element of regulatory protection—social needs. Europe was not, therefore, following the United States model: there was a distinctive European model. Key elements of social policy (universal service, protection of vulnerable groups) were written into directives, but the details of implementation were left to Member States and national regulators. The Commission was pragmatic, seeking ways to integrate public service obligations with a pro-market stance. The whole endeavour was premised on the benefits to customers and citizens.

The growth in the EU to 25 Member States meant that there would be a continued need for regulation and for it to be independent of government, albeit fully accountable. The objective was to have ‘competent’ authorities in place (that is, political credentials alone were insufficient). The objective was effective competition—competitive prices rather than lower prices *per se*, although this could result as long as security of supply was achieved. One policy was to disengage gas from oil prices because oil prices were mainly set by a cartel. Reducing cartel power could be achieved by the EU using its negotiating power to demand greater transparency—the EU was the largest importer of energy in the world.

Public Consultation

Good regulation in the hands of competent authorities was the key to confidence building in liberalisation, but involved initiatives such as the ‘Passenger Charter of Rights’. The absence of user representative bodies across Europe was recognised by the Commission. BEUC did not have the capacity to generate all the necessary responsible dialogue, and trade unionists were not true user representatives. The Commission wanted to facilitate developments in this regard and a new initiative was forthcoming, based on working through member states to promote and invite representative bodies to participate.

Co-ordination and harmonisation

Co-ordination was seen as essential to the development of the internal energy market (with reference made to the recent ‘black-outs’ in Italy). Harmonisation consistent with subsidiarity principles could result. The Florence conference had identified two common competencies for the EU: (i) fair access based on non-discrimination and (ii) control of the methodology for tariffs. Co-ordination of ‘congestion management’ was particularly

important, and the policy was to reach the level of 10 % of electricity capacity on European interconnection to underpin security of supply.

If co-ordination and harmonisation led to acceptance of the need for pan-European regulation, then accountability would require a supervisory role for the European Parliament. Accountability of regulators to member state parliaments did not compromise independence, but helped to instil the right attitude in regulators and enabled them to be a permanent bridge between the technical and political realities.

Meeting with Mr. Alexander WILLAN, DG "Information Society"

Mr Willan has worked since 1999 in the Unit which deals with the implementation of the EU regulatory package for electronic communications (including telecommunications) and is the desk officer responsible for following implementation of the new framework in the UK. Prior to this, he worked to develop the EU regulatory framework for postal services.

The Regulatory Model

Mr Willan said that the UK and Finland were among the first countries to liberalise telecoms. Ofcom had been very successful: it had a good reputation for independence and had anticipated events in most other Member States. The success of the independent regulatory model in the UK had helped to remove doubts about its effectiveness in other countries.

The key attributes of a National Regulatory Authority (NRA) were independence, impartiality and transparency. In holding the balance between the market and consumers regulators had to consult at both national and EU level and make clear their reasons for their decisions. The BRTF 5 Principles of Better Regulation informed the legal framework, but the principles themselves could not easily be enforced.

Appeals

The best accountability, however, was legal: the Commission had established a transparent legal framework regulating electronic communications which promoted the consumer interest, for example, with regard to universal service provision. The framework required dispute resolution procedures, but also established the principle of allowing appeal to independent bodies both on the merits of NRA decisions as well as on due process.

In terms of making this appeals system work, the framework only set objectives and principles: it was up to Member States to implement the administrative procedures. To prevent vexatious legal challenges, however, any NRA decision should in principle stand pending appeal. Consumers should not initially refer complaints directly to the Commission, but should first seek recourse at national level, particularly through NRAs.

Consumers

The Commission was reluctant to distort competition, even where it resulted in outcomes consumers did not like. The EU regulatory framework for electronic communications was based on minimum regulatory intervention and favoured the promotion of competition. In the case of the opening up of directory inquiries services in the UK, customer dissatisfaction was due to the poor quality of service from some providers. There was no regulatory solution to this problem; this was part of the bedding-in process. The EU could only create and enforce a level playing field for competition. Competition would eventually remove the poor providers and there would be long-term benefits.

Co-ordination

The Commission brought regulators together through the new Electronic Communications Framework. The Communications Committee involved Member States and NRAs in general discussions; the Committee had to be consulted before the Commission could adopt recommendations; and the Committee had a formal consultative role where the Commission vetoed measures taken by an NRA to implement directives.

In addition the Commission facilitated the European Regulators Group: this had no formal legal powers but was a discussion forum which could assist compliance through the exertion of peer pressure. The Radio Spectrum Committee was a specific group which was consulted by the Commission on harmonisation proposals for spectrum use.

In terms of promoting regulatory good practice, the Commission had issued a communication, but could do more.

RIAs

RIAs were part of the legislative procedure but were not given priority. There were, however, requirements for financial impact assessments, and the process of consultation and market analysis also identified potential costs. The directives establishing the electronic communications framework also contained provisions for the Commission to review the economic impact of implementation measures adopted.

Economic and Content Regulation

Economic and Content Regulation were often hard to separate in practice. There could be an advantage in one body considering both, but the nature of the activities was different. Content regulation was highly political, and there could be a risk that political considerations could spill over into areas of economic regulation.

Meeting with Mr. Emil PAULIS, Director, DG “Competition”

Mr Paulis has extensive experience in working in DG Competition in relation to Mergers, Legislation and relations with Member States. He is Director of Policy Development and co-ordination.

The dual nature of DG Competition

Mr Paulis spoke about the dual nature of DG Competition as both a law-making and a law-enforcing body. The Competition Commissioner (currently Mario Monti) had a special remit to conduct investigations to enforce competition law. The final outcome of any investigation, however, was made as a collegiate decision by the Commission as a whole. As the Commission had no budgetary power in these areas there was no conflict of interest: the Commission was independent. In theory any Commission decision to overturn the conclusions of DG Competition would not be made public; in practice events were often leaked to the press. This was an additional encouragement for the DG to operate in a transparent manner.

The advantage of this ‘administrative justice’ was that companies could discuss cases with the DG in advance. They could also criticise decisions and help the Commission to avoid repeating mistakes: following the Airtours decision, the media outcry helped to bring about reform within the DG. By contrast advance discussions with judges or criticism of their decisions were not permissible. There were advantages to both Judicial and Administrative justice: the key factor was the quality of the people involved.

Once the Commission had taken up a case, the Member State no longer had competence. The case would go to the ECJ if appealed.

Scrutiny of the Annual Report

The DG published an annual report and a forward plan. The Commissioner was called to give evidence on these every year by the Economic and Monetary Affairs Committee of the European Parliament. The Committee would then adopt the annual report together with their own recommendations. The Commissioner then replied to explain his position and his reaction to the recommendations.

Consultation

The DG consulted constantly with Member States. Advisory Committees met every week to discuss draft decisions. These Committees produced an opinion which was sent with the draft decision to the Collegiate Commission. This culture of co-operation had often led to changes in draft decisions. The European Competition Network obliged the Commission to consult Member States, but also *vice versa*.

Ninety-nine per cent of consultation took place with industry. Consumers were hard to access as they were not organised, had little expertise, and there was little incentive for an individual to respond to consultations. This gap was filled by the civil service impartiality of the Commission itself which took on the role of consumer champion to ensure a balanced view.

Decentralisation

Decentralisation had led to more work for the Commission, not less. The Commission gave general guidance on competition law; all draft decisions by Member States had to be notified to the Commission; and from 1st May the Commission was obliged to help the judges of Member States with specific queries in the field of competition law. This last obligation was potentially an enormous increase in workload.

Decentralisation did, however, result in faster decisions. The system of notification would have to end, and enforcement would be left to Member States. Local enforcement had the further advantage of greater acceptance of legal decisions.

Enforcement

Private legal action was essential to the enforcement of competition law—no central authority could be as effective. In the US companies feared private cases far more than actions brought by the state. This was because, if proved, losses were multiplied by three, punitive damages could be awarded, and costs were always awarded against the defendant. By contrast, in the EU it was almost impossible to be successful, although there were now some private actions in the UK (for example against the directors of Equitable Life).

It was theoretically possible that the Commission could have to pass judgment on itself as a regulator. However, Mr Paulis was strongly against the idea of a separate European Competition Agency. To ensure balance between Member States it would have to constitute itself as a mini Commission with representatives from all Member States. An Agency would be subject to strong political pressure. He would prefer a judicial system to a separate Competition Agency. As it was, the Commission gave judgment based on a European outlook, and did not take account of national interests.

Meeting with Mr. Tom Jenkins, Senior Adviser, ETUC

Mr Jenkins has only recently moved to ETUC. Prior to this post he worked for the TUC in the UK dealing with European issues.

Consultation

Mr Jenkins spoke about his experience in Brussels and Whitehall. In general the Commission was more open and consulted better. Formal structures such as the Economic and Social Committee advised the Commission and other institutions; there were a range of tri-partite Advisory Committees; and there were special procedures under the treaties for input by Social Partners on aspects such as Health and Safety legislation (for example with respect to the new Chemicals policy). There was also considerable informal discussion with the Commission. The Commission, however, usually ended up reflecting the views of Governments.

The ETUC would like to be consulted not just on labour market issues but on wider matters such as company law. The takeover directive would have a significant impact on workers but they had not initially been formally consulted. The ETUC was sometimes seen as a subsidiary body of DG Employment and Social Affairs. On social policy the ETUC had an impact, but this was less in other areas where they had to rely on lobbying the European Parliament and the Council.

The Executive Committee of the ETUC was formed by the leaders of national TUC bodies: their views were thus representative of their national members. The ETUC could also claim to represent the wider community as individual members often represented families. Their views also often coincided with those of consumer groups, and they worked with NGOs on specific issues: this was often more successful than working with general consumer groups (such as BEUC).

Role of the ETUC

The ETUC had difficulty in responding to all the consultations issued by the Commission as they only employed a small number of people. Much was left to national TUC bodies with offices in Brussels. The ETUC did, however, seek to harmonise the approach of national TUC bodies, and represented them before the institutions.

The ETUC in Europe, and the TUC in the UK, lobbied on specific pieces of legislation but not so much on decisions taken by regulators fulfilling their functions. Complaints were made to the Commission where governments were in breach of their obligations under EU law, and cases had been taken to the court.

Accountability

The Commission was gradually becoming more accountable to the European Parliament (although its drift to a free market ideology, driven by the Council, was not welcomed by the ETUC).

Citizens generally were not well-represented directly, except through the advisory Economic and Social Committee. Politicians had the main role in representing the interests of citizens. The Committee of the Regions had not been as successful as had been expected, and there had been tension between their representatives and the constituency representative to the European Parliament... Ombudsmen also had a role in protecting the consumer interest.

There was a balance between independence and accountability. The ETUC would like the European Central Bank to be more accountable, but there were at least procedures for dialogue with social partners which had no equivalent in the UK. Openness and transparency were vital to effective accountability.

APPENDIX 8: SUMMARY OF EVIDENCE BY TYPE

Background Oral Evidence

The Committee began by hearing from a number of ‘background’ witnesses to inform themselves about the processes of regulation. These witnesses divided into ‘academics’ and ‘ex-regulators’, although many ex-regulators also have a strong background in industry while others still work in regulated industries (Clare Spottiswoode, for example, is currently a director for British Energy).

TABLE 1

Background information by type of witness

<i>Academics</i>	<i>Ex-regulators</i>
Christopher Hood (informal session) ²¹³	Ian Byatt
Tony Prosser	Bryan Carsberg
Mark Thatcher (for international comparisons)	Stephen Littlechild
Peter Vass	Clare Spottiswoode
Sir Christopher Foster	John Swift

Written Evidence

The Committee issued a call for evidence in early January. The deadline for submission of written evidence was 31st March, although evidence continued to be submitted long after that date. The following table gives the approximate figures for the number of submissions received relating to each sector and by type of witness.

TABLE 2

Number of Written submissions

<i>Sector</i> ²¹⁴	<i>Regulators</i>	<i>Industry</i>	<i>Consumers</i>
General	13 ²¹⁵	1	2
Gas and Electricity	1	7	1
Water	1	2	1
Postal Services	1	1	1
Rail	1	0	0
Air	1	3	1
Financial Services	3	35	3
Education	3	0	0
Communications	5	2	0

Note: these figures are only approximate as many bodies are cross sectoral

²¹³ A summary of Professor Hood’s informal briefing is at Appendix 10.

²¹⁴ A number of submissions were cross sectoral; a number of others do not fall into any category, such as those by the Hansard society, the European Policy Forum, submissions by the DTI, and those by Mr Henney.

²¹⁵ Includes ombudsmen and bodies such as the Environment Agency and the National Lottery Commission.

Further Oral Evidence

TABLE 3
Oral Witnesses by Sector and by Type

<i>Sector</i>	<i>Regulators</i>	<i>Industry</i>	<i>Consumers</i>
General	Office of Fair Trading Competition Commission Environment Agency		National Consumer Council
Gas and Electricity	Ofgem	(i) Electricity Association (ii) Gas Forum (iii) British Energy	Energywatch
Water	Ofwat	Water UK	WaterVoice
Postal Services	Postcomm	Royal Mail	Postwatch
Rail	Office of the Rail Regulator		
Air	Civil Aviation Authority		
Financial Services	Financial Services Authority	Financial Services Practitioner Panel Association of Independent Financial Advisers	Financial Services Consumer Panel
Communications	OFCOM	Mobile Broadband Group (formerly UK Mobile Operators)	

The Committee also took evidence from Mr Stephen Timms MP (DTI Minister); and the Competition Appeal Tribunal

APPENDIX 9: CHRONOLOGICAL TABLE OF SELECTED REGULATORS

Sector	Inception	Current position	Primary duties (secondary duties noted)	Consumer body	Appeals via:
NATIONAL AND CROSS-SECTORAL REGULATORS	1948: Monopolies and Mergers Commission (MMC), initially the Monopolies and Restrictive Practices Commission until 1973 - powers extended by the Competition Act 1980.	Competition Commission: from 1999, following the Competition Act 1998.	To conduct inquiries (as referred to it by OFT and other parties) into mergers, market operation and economic regulation of network industries.	All interested parties, including consumer bodies, enabled to participate in providing evidence to inquiries - reinforced by super-complaint status following the Enterprise Act 2002.	Competition Appeal Tribunal (CAT) Judicial Review
Competition and Fair Trading	1973: Director General of Fair Trading, following the Fair Trading Act 1973. Office of Fair Trading (OFT)	OFT: a board structure with executive chairman, with effect from 2003 - powers most recently modified by the Enterprise Act 2002, which ended ministerial involvement in merger and market investigations.	A competition and consumer protection authority (eg, mergers and market operation), rather than a sectoral regulator (Ofcom, Ofgem, Ofwat, ORR and CAA apply Competition Act 1998 concurrently (2000)). Specific responsibilities to ensure 'fit' persons hold consumer credit licences or are estate agents.	OFT does not have a role in seeking redress for individual consumers or front-line enforcement of consumer law (trading standards are the responsibility of local authorities).	Competition Appeal Tribunal (CAT) Judicial Review Appeal to Secretary of State for Trade and Industry re consumer credit licences

Health and Safety	1974: Health and Safety Commission (HSC) Health and Safety Executive (HSE)	HSC HSE	To secure the health, safety and welfare of people at work; to protect the public against risks arising from work activities; to control dangerous substances.	No consumer body - consults a wide range of special interests.	Judicial Review Secretary of State for Work and Pensions Tribunals as appropriate Parliamentary Commissioner for Administration
Environment	Three main bodies: National Rivers Authority (NRA) 1989 HM Inspectorate of Pollution Waste Authorities (local authority responsibility)	The Environment Agency: from 1996 following the Environment Act 1995 in order to provide integrated pollution control.	Duties include: flood risk management; reducing industries' impacts on the environment (air, land and water); waste and radioactive management; managing water resources and improving wildlife habitats and fisheries.	No associated consumer watchdog, but consults statutory regional committees and national representative bodies, as well as the public generally.	Magistrates Courts Judicial Review Secretary of State for the Department of the Environment, Food and Rural Affairs (DEFRA)

SECTORAL REGULATORS <i>Financial Services</i>	Financial services regulation dealt with by many bodies, including: Building Societies Commission; Friendly Societies Commission; Investment Management Regulatory Organisation; Personal Investment Authority; Register of Friendly Societies; Securities and Futures Authority; Bank of England; Securities and Investments Board (SIB)	Financial Services Authority (FSA): from 1997 following the merging of banking supervision and investment services regulation into the Securities and Investments Board (SIB), which renamed itself the FSA. The Financial Services and Markets Act 2000 incorporated the other predecessor bodies.	The four objectives are: maintaining market confidence; promoting public understanding of the financial system; securing the appropriate degree of protection for consumers, while having regard to the general principle that consumers should take responsibility for their decisions; reducing financial crime through regulated businesses.	Consumer Panel	Financial Ombudsman Competition Commission Competition Appeal Tribunal (CAT) The Regulatory Decisions Committee Judicial Review The Financial Services and Markets Tribunal The Independent Complaints Commissioner
Communications and Broadcasting	1984: Director General of Telecommunications Office of Telecommunications (OfTel) There were also the: Independent Television Commission (ITC); Radio Authority; Broadcasting Standards Commission; Radio Communications Agency of the DTI	Office of Communications (Ofcom): established 2002 with a board structure, empowered from December 2003 by the Communications Act 2003 - incorporating its five predecessors.	To further ²¹⁶ : the interests of consumers in relevant markets, where appropriate by promoting competition; the community as a whole in relation to communications; by inter alia: optimal use of the electro-magnetic spectrum, wide availability of electronic communications services, high quality and varied television and radio services with standards to protect the public from offensive material and unfair treatment, and plurality of media ownership.	Consumer Panel	Competition Commission Competition Appeal Tribunal (CAT) Judicial Review

²¹⁶ With many associated secondary duties, including applying the principles of good regulation and best practice.

Airports	1972: Civil Aviation Authority (CAA)	CAA Economic regulation of airports: from 1986 with privatisation of BAA. Regulation of air traffic services - re National Air Traffic Services (NATS): from 2001 following PPP.	To further the reasonable interests of users of airports; efficient, economic and profitable operation; to encourage investment to meet demand; to impose minimum restrictions consistent with regulatory functions; to maintain a high standard of safety in provision of air traffic services.	Air Transport Users Council	Competition Appeal Tribunal (CAT) Judicial Review
Energy	1986: Director General of Gas Supply Office of Gas and Supply (Ofgas)	Gas and Electricity Markets Authority (GEMA): from 2000 following the Utilities Act 2000. Office of Gas and Electricity Markets (Ofgem)	To protect ²¹⁷ : the interests of consumers where appropriate by promoting effective competition.	Energywatch	Competition Appeal Tribunal (CAT) Competition Commission Judicial Review
	1990: Director General of Electricity Regulation Office of Electricity Regulation (Ofreg)				

²¹⁷ Secondary duties include to have regard to: all reasonable demands being met; the interests of disabled, chronically sick, pensioners, people on low incomes and rural residents; the ability of licence holders to finance their activities; social and environmental guidance issued by the Secretary of State; to secure a diverse and viable long term energy supply; to protect the public from danger.

Water <i>(England/Wales)</i>	1989: Director General of Water Services Office of Water Services (Ofwat)	The Water Services Regulation Authority: these provisions of the Water Act 2003 to be implemented from 2005. Ofwat	To ensure ²¹⁸ : the functions of water and sewerage providers are properly carried out; that companies are able to finance their functions; and to further the consumer objective.	WaterVoice	Competition Appeal Tribunal (CAT) Competition Commission Judicial Review
Rail	1995/1996: Office of Passenger Rail Franchising (Opraf)	Strategic Rail Authority (SRA): from 2001 following the Transport Act 2000.	To provide strategic leadership for the railway industry and ensure co-operative working; to secure the development of the railway network; to protect the interests of users of railway services; to let and manage passenger franchises to train operating companies on behalf of the Secretary of State.	Rail Passengers Council	Judicial Review
	1993: The Rail Regulator The Office of the Rail Regulator (ORR)	The Office of Rail Regulation (ORR) with a board structure: from 2004 following the Railways and Transport Safety Act 2003.	To protect the users of rail services (prices and quality); to promote the use of the railway network, competition, measures to facilitate multi-operator journeys, and to impose minimum restrictions consistent with regulatory functions; to enable service providers to plan with reasonable assurance; to facilitate the furtherance of SRA strategies.		Competition Appeal Tribunal (CAT) Competition Commission Judicial Review
Postal Services	2000: Postal Services Commission (Postcomm)	Postcomm	To ensure ²¹⁹ : the provision of a universal postal service at an affordable and geographically uniform price.	Postwatch	Competition Commission Judicial Review

²¹⁸ Secondary duties include: no undue preference (cost-reflectivity); to promote economy and efficiency; to facilitate competition; to promote efficient water use; to have regard to the principles of best regulatory practice (including the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed).

²¹⁹ To further the interests of postal users, wherever appropriate by promoting effective competition; to have regard to those who are disabled, pensioners, on low incomes or rural dwellers; to promote economy and efficiency and to ensure licence holders can finance their activities.

APPENDIX 10: SUMMARY OF BRIEFING BY PROFESSOR HOOD, ALL SOULS COLLEGE, OXFORD ON 25 FEBRUARY 2003

Professor Hood defined three different types of regulation, and outlined three studies. In particular, he discussed: (i) how OFTEL operated at the time of the study, including its relations with consumers and complainers; (ii) the growth of public-sector regulation within Whitehall; and (iii) the substantial variation in risk regulatory regimes, noting the influence of interest groups and the importance of ‘blame-avoidance’ within regulators as significant factors. This third study further incorporated a critique of the ‘principles of better regulation’ as being both proverbial and contradictory.

Professor Hood concluded that: (i) standard-setting was only one aspect of regulation; (ii) the accountability of regulatory regimes should take account of the multiple institutions within them; and (iii) prescriptions for better regulation, beyond simple criteria of economic efficiency, are unsophisticated.

In terms of composition and accountability of regulators, Professor Hood noted that:

- regulators differed widely. For example, the Office of the Rail Regulator had a single head; OFGEM had a board (appointed by Ministers); and the FSA was constituted as a company with Directors appointed by the Treasury;
- his study of public-sector regulation had identified eight main types of regulator and a number of different methods of oversight, including authorisation (giving approval before the event), and post hoc evaluation;
- the use of the word ‘regulation’ for internal, public-sector control and auditing was controversial within Government, but studies showed that such activity had recently increased, whatever precise definition was used; and
- regulators themselves considered that they had multiple accountability — they were under pressure from all sides.

In response to questions from members, Professor Hood further said that:

- interest groups were often more influential than public opinion in shaping the creation and operation of regulatory regimes;
- public-sector regulators rarely met, and often took little account of each other’s work. This could lead to regulatory overlap (the need to provide the same information to different regulators in slightly different formats);
- discretion was an intrinsic part of regulation, as conventionally understood;

Local Authorities exercised significant regulatory powers;

- some regulators were accountable to devolved administrations; indeed, some had dual accountability; and
- regulation was never ‘value free’, but involved trade-offs: arguments regarding a universal postal service, for example, had to balance community values and commercial efficiency.

Areas for further consideration

Professor Hood considered that the most profitable, *constitutional* issues for the Committee to focus on were:

- the shifting balance between ministerial responsibility and the responsibility of regulators, for example in competition policy decisions (repatriated by the EU to national level, but to regulators rather than Ministers);
- the advantages and disadvantages of a single regulator compared to the board model, particularly in regard to accountability; and
- the different institutional forms that could be used for regulation, such as ministerial and non-ministerial departments, NDPBs, and companies; and how different forms of organisation affect accountability.

Other matters which the Committee could profitably consider were:

- how regulators could be defined and mapped;
- how recipes for, and attitudes to, regulation have altered over time (such as the move away from simple price-control regulation; and the merging of competition and utility regulation);
- the extent of mutuality among regulators as a method of spreading best practice and avoiding overlap;
- the extent to which principles of good regulation could provide a framework for balancing trade-offs in regulatory systems;
- how compliance costs are understood and assessed (noting that companies tend to declare maximum costs, regulators minimum ones);
- how citizens understand regulators, particularly with respect to their functions of setting standards, enforcement, and information gathering; and
- the effectiveness of disputes mechanisms.