PUBLIC LAW IN A MULTI-LAYERED CONSTITUTION

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UK Utility Regulation in an Age of Governance

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INTRODUCTION

THIS CHAPTER DISCUSSES UK utility regulation in a constitutional and legal context and in doing so encounters a number of issues that are central to this collection of essays. For example, it will be apparent that any discussion of regulation is closely related not only to how different layers of power are exercised in the contemporary state but to understanding the range of mechanisms that are available to control the exercise of this power.

The public utilities of gas, electricity and water not only remain of great importance to the national economy but their operation and performance have enormous economic, political and environmental implications, and although the Labour party came to power in 1997 having accepted privatisation as a permanent feature of the economic landscape, the performance of the privatised utilities in particular has continued to be a matter of pressing public concern.[1] In this chapter, I will first consider the shifting position of public utilities and their regulation in constitutional and legal terms, but another important theme is an assessment of the different types of regulation and the impact of devolution on the regulatory process. In recent years the utilities have been reformulated into 'a complex network of service delivery arrangements'[2] which have been further compounded by the introduction of a layer of devolved government for Scotland, Wales and Northern Ireland. In relation to the utilities, it would appear that a number of diverse statutes has led to a redistribution

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[1] Nevertheless, it was believed by Labour Party policy-makers that some of the utilities had been disposed of below their market value and this anomaly was tackled by a 'one off' windfall profits tax of £5.2bn, introduced in the budget of July 1997, following Labour's first general election victory for 18 years. See P Stephens 'The Treasury under Labour' in A Seldon (ed), *The Blair Effect: The Blair Government* 1997–2001 (London, Little Brown, 2001) at pp 195.

[2] A Midwinter and N McGarvey, 'In Search of the Regulatory State: Evidence from Scotland' (2001) 79 *Public Administration*, (No 4) 825.

of powers and functions among the devolved executives and regulators, but that this has taken place without any regional strategy.[3]

At an institutional level we will see that, in the contemporary state post-privatisation and devolution, the channels of accountability to Parliament through ministers have been significantly modified and only operate indirectly as one of a number of mechanisms through which the activities of the utility sector are made accountable.[4] Most obviously this has included the introduction of utility regulators for each industry who 'now play a critical role in national economic management, exercise a power to make decisions worth literally billions of pounds to the stock market value of companies, and are second only to the Chancellor of the Exchequer in the influence they wield over the family budget.'[5]

In seeking to regulate in this sector, regulatory authorities very often intervene in what would otherwise be an economic arena. The problem then becomes deciding upon the degree to which socio-political considerations will be allowed to interfere with the more technical questions that are likely to be involved with economic regulation.[6] In fact throughout this discussion it will be evident that there are distinct and often conflicting objectives for regulators which are usually recognised by and incorporated in the legislation itself, and although the competing weights given to these considerations are of vital importance, no clear formula for resolution is provided by the statutory framework under which they operate. For instance, on the one hand, should the task of regulation be predominantly concerned with promoting competition, controlling prices, safeguarding profitability, promoting one industry in preference to another? Or, on the other hand, should it be concerned with protecting consumer interests and safeguarding the environment? This problem presents itself because social and economic priorities cannot be resolved at an entirely technical level and this may set limits on what any form of statutory regulation can achieve on its own. Indeed, the intention behind exposing these industries to market forces was to place aspects of their operation beyond the domain of public law, while at the same time exercising a substantial degree of control over other aspects of their operation in the public interest. In demonstrating how utility regulation features on a map of public and private power it will be evident that the privatised utilities continue to be contested territory between the public and the private[7] and that this is an area that illustrates a shift in the role of the state from when it exercised a more active 'rowing' function towards it having a rather less intrusive 'steering' function.[8]

Moreover, despite being significant players in the regulatory game, statutory

[3] See later discussion of the gas, electricity and water industries.

[4] C Scott, 'Accountability in the Regulatory State' [2000] *Journal of Law and Society* 38, 48.

[5] C Harlow and R Rawlings, *Law and Administration* 2nd ed (London, Butterworth, 1997), 313.

[6] T Prosser, *Law and the Regulators* (Oxford, OUP, 1997), 4 *et seq.*

[7] J Allison, *A Continental Distinction in the Common Law: A Historical and Comparative Perspective on English Public Law* (Oxford, Clarendon, 1996), 101–3.

[8] See D Osborn and T Gaebler, *Reinventing Government* (New York, Addison Wesley, 1992) and M Taggart 'Reinvented Government, Traffic Lights and the Convergence of Public and Private Law. Review of Harlow and Rawlings: *Law and Administration*' [1999] *Public Law* 124, 133.

regulators are by no means the only participants.[9] It will become evident as we proceed with our discussion that there is an intricate web of interrelated issues that surround utility regulation and a 'regulatory space metaphor' has been employed to indicate that the resources relevant to holding regulatory power are dispersed and fragmented.[10] This is further evidenced by the lack of any easily identifiable public/private law distinction.[11] Furthermore, regulation is not restricted to formal state authority derived from legislation or from contracts.[12] Rather, our understanding must be related to the complexity of policy networks which are now characteristic of modern governance and which involve an interplay between government and an expanding range of public, private and hybrid bodies leading to 'complex, dynamic and horizontal [relationships] involving negotiated interdependence.'[13] There are various accountability methods which operate uniquely within each policy domain and these have the character of a system of checks and balances in which particular forms of behaviour are inhibited or encouraged by the overall balance in the system at a particular time.[14] In the case of the privatised utilities, this process includes several regulators and the consumer groups they serve.[15] In fact, the need for a multi-layered engagement with such issues has been recognised by the Government itself as essential.[16] The 'Modernising Government' initiative has encouraged moves towards 'joined up' government.[17] Any such approach clearly has important implications for institutional

[9] For example, it has been suggested that the supervision of service delivery takes place at different degrees of formalism. In this regard executive departments need to be distinguished from the task of regulation where the regulator has real power. See Midwinter and McGarvey, above n 2, at 833.

[10] See L Hancher and M Moran, 'Organising Regulatory Space' in L Hancher and M Moran, *Capitalism, Culture and Regulation* (Oxford, Clarendon, 1989), 271.

[11] Peter Cane explains, in chapter 10 below, n 67, how the concept of 'hybridisation' has been developed by regulation scholars to describe and analyse certain social activities regardless of their institutional form.

[12] The mechanism of the licence is crucial as it sets the levels of competition and is required by the regulated industry to carry on its business. See T Prosser, 'Regulation, Markets and Legitimacy' in J Jowell and D Oliver, *The Changing Constitution* (4th edn, Oxford, Oxford University Press, 2000), 240.

[13] C Scott, 'Analysing Regulatory Space: Fragmented Resources and Institutional Design' [2001] *PL* 330. For an analysis of evolving techniques for the exercise of public and private power in the context of 'e-government' and governance more generally, see John Morison, ch 7 above.

[14] Scott, above n 4, at 55.

[15] This discussion will be concerned with setting out and analysing institutional relationships at an empirical level in terms of structure, constitutional and wider accountability, but it is worth recognising that explanatory models have been proposed as a tentative framework for revealing horizontal and vertical 'directions' of accountability which arise in regard to these overlapping policy networks. A vertical axis registers whether this is to a higher authority, to a parallel institution; or to lower level institutions or groups. The horizontal axis deals with the objective of the accountability identified in terms of economic values (including financial probity and value for money); social/procedural values (such as fairness, equality and legality); continuity security values (such as social cohesion, universal service and safety). See Scott, above n 4, at 42.

[16] See R Rhodes 'The Civil Service' in A Seldon (ed) *The Blair Effect: The Blair Government 1997–2001* (London, Little Brown, 2001), 100. It is pointed out that there has been a significant shift in regulatory philosophy under Labour, with a growing awareness of the cost of regulation and the need for consistency of practice between regulators.

[17] *Better Regulation Task Force: Economic Regulators, 2001* (Cabinet Office, 2001); White Paper *Modernising Government* (Cm 4310, 1999); and the manual from the Performance and Innovation Unit, *Wiring It Up* (2000).

design, since recognising this degree of complexity also has the effect of questioning the predominant role of the state and its capacity to intervene effectively.[18] We shall see that, in practice, there is limited coherence between regulatory bodies, and between the other watchdog and co-ordinating mechanisms which have often been improvised to fulfil a particular policy role.[19]

FROM PUBLIC TO PRIVATE OWNERSHIP/STANDARD FORM OF NATIONALISATION

The nationalised industries, and particularly the utility and transport sector, are of vital strategic importance to the national economy, but this needs to be related more precisely to their legal status and their constitutional position. In this section we will briefly consider the organisation under state ownership in order to demonstrate how the strands of power and the system of accountability evolved from the public corporation model established by nationalisation.

The extension of public ownership was pursued by the Labour government, mainly during the post-war administration between 1945–1951, but as Ewing notes:

> although many of the instruments of production, distribution and exchange were socialised in terms of ownership ... this did not necessarily lead to the effective accountability of these institutions to the people on behalf of whom they were owned.[20]

Indeed, the rationale and the form of nationalisation as it was introduced had more to do with the economic failures of the industries in question[21] and to their strategic importance to the overall performance of the economy, than to any clear commitment to radical social ownership. In particular, the public utilities, which are the main concern of this chapter, were large scale monopolies relying heavily upon state subsidy.[22] Also, the post-war Labour Government and the Labour Governments of the 1960s were committed to economic planning. In consequence, 'in all of these examples, a strong pragmatic case existed, in line with classical principles of free competition, for eliminating private monopoly by taking essential utilities into public ownership.'[23] A broadly Keynesian approach to economics identified a key role for governments in managing a tendency toward imbalance. The formula attributed to Herbert Morrison and applied to London Transport in the 1930s became a model for nationalisation. This typically involved Parliament passing an

[18] Scott, above n 13, at 346.

[19] One such example is the invention of the 'Strategic Rail Authority' as a response to shortcoming in the rail industry. See the Transport Act 2000.

[20] See K Ewing, 'The Politics of the British Constitution' [2000] *Public Law* 418.

[21] A Taylor, *English History* 1914–45 (London, Penguin, 1970), 616 notes that 'British industrialists had got into the habit during the inter-war years of turning to the state when they ran into difficulties.

[22] It should be noted that in the transport sector the four oligopolistic and loss-making UK rail companies were nationalised in 1948 to form British Rail. This was subsequently privatised under the provisions of the Railways Act 1993.

[23] P Clarke, *Hope and Glory: Britain 1900–1990* (London, Penguin, 1996), 225.

enabling statute which established a separate corporate identity for the industry and exclusive ownership by the state. The corporation could be financed independently from borrowing, with the statute sometimes containing provision to raise capital by the issue of bonds. These industries often received substantial government subsidies and were exempted from direct parliamentary financial control. The internal conditions of operation varied according to each industry but they were not staffed by civil servants. Personnel were recruited and paid under conditions established by the corporation on standard contracts of employment.

It is also important to consider the mechanisms for ensuring constitutional accountability for the operation of these corporations. In virtually every case, under the enabling statute the relevant minister appointed a Chairman and a Board which was given responsibility for the day-to-day running of the corporation/nationalised industry, while the minister gave final approval for strategic issues involving capital investment. But government involvement did not end here, since the minister could not only insist on being supplied with information, but in some cases could give directions of a general nature as to the exercise or performance by the Board of their functions in relation to matters appearing to the minister to affect the public interest.[24] In fact this power was hardly ever used, but it is widely recognised that ministers increasingly intervened in operational matters such as price-setting, employment and wages.[25] In regard to ministerial accountability to Parliament and before select committees it was a problem, in practice, to distinguish between day-to-day operations which were deemed the responsibility of the Board, and general policy, which was the responsibility of the minister.

The hand of government was felt in other ways too. For instance, the Treasury was in a position to intervene by setting financial targets and by subjecting each industry to cash limits in relation to any subsidy that was provided. The Monopolies and Mergers Commission (MMC) conducted reviews of efficiency and was responsible for the imposition of effective methods of financial control.[26] The obvious problem in the utility sector was a familiar one, namely, how to give the nationalised industries adequate commercial freedom, while simultaneously maintaining sufficient public control to ensure that they followed the government's overall economy strategy and social objectives.[27] The point that must be stressed is that from the formation of the nationalised industries under public ownership, the Government still had to set a balance between the social and public interest aspects of the industry as against its commercial viability and profitability. Indeed, we will see throughout our discussion that such considerations have remained a fundamental underlying issue. For example, the Herbert Report stressed, in relation to the electricity industry, the importance of pursuing self interest as a commercial concern as the best means of serving the national economy and later drew the conclusion that the industry ought

[24] A Hanson and M Walles, *Governing Britain* (4th edn, (London, Fontana, 1990), 207 *et seq.*

[25] See M Thatcher, 'Institutions, Regulation and Change: New Regulatory Agencies in the British Privatised Utilities' (1998) 21 *West European Politics* 120, 122–23.

[26] See J McEldowney, *Public Law* (London, Sweet & Maxwell, 1997), 433. Now the Competition Commission. See below n 75.

[27] Hanson and Walles, above n 24, 206.

not to be absolved from economic and commercial justification.[28] An identical tension between commercial and social considerations remains in place under revised arrangements which exist post-privatisation.

Under nationalisation the economic performance of the utilities could easily be manipulated to favour government policy. As we have seen, the Board was appointed by and indirectly responsible to the minister for matters of overall strategy. However, the fixing of pricing levels was a matter left to the Treasury, and the charging parameters for these essential services could be used as a form of surrogate taxation.[29] Prior to privatisation, these industries were encouraged to follow commercial business practices and they were allowed to charge market rates for some of their services.[29a] Other services were deliberately offered at a loss and several of the utilities were in receipt of public subsidy. In spite of limited accountability and a strong tendency towards monopoly domination, nationalisation succeeded in delivering a remarkably universal standard of utility services throughout the entire United Kingdom. In terms of energy policy this meant that the Government was in a position to make strategic decisions about long-term investment and on what emphasis to place on the use and exploitation of the various sources of energy that were available.

PRIVATISATION AND REGULATION

Privatisation was pursued as one of the main ideological objectives of the Thatcher/Major Governments. A general intention was to apply market driven solutions to the structural problems of governance.[30] Publicly owned industries were characterised as beached whales that were considered both inefficient and a burden on the tax-payer. The plan was to turn them into the glowing beacons of a new enterprise culture.[31] Moreover, the Treasury stood to benefit from the proceeds of privatisation as the government sold off its stake. Also, the flotation of shares on the stock exchange provided the opportunity to further a wider aim, namely, to create a shareholding democracy by extending the scope of private share ownership. The ultimate goal for advocates of this policy was to produce a truly competitive market

[28] A White Paper published by the Conservative Government, *Financial and Economic Obligations of the Nationalised Industries* (April 1961). See A Sampson, *The Anatomy of Britain* (London, Hodder & Stoughton, 1961), 537.

[29a] See eg *Financial and Economic Obligations of the Nationalised Industries* (Cmd 1961), Nationalised Industries: A Review of Economic and Financial Objectives (Cmnd. 3437 (1967)).

[29] T Prosser, *Nationalised Industries and Public Control* (Oxford, Blackwell, 1986), 63–69. The Treasury imposed high pricing levels to provide more funds for the Government without having to raise taxes.

[30] Governance is employed as a broader concept than government which, for example, takes account of the changing boundaries of the state and the interaction between public, private and voluntary sectors in the implementation of policy. For detailed discussion see Morison ch 7 above p 138, and R Rhodes, *Understanding Governance* (Buckingham, Open University Press, 1997).

[31] British Airways might be cited as an example of a privatised industry which has operated successfully as a private company exposed to competition without a regulator. But BA was given enormous economic advantages over competitors by having the pick of the most profitable air routes.

environment for these industries, replacing the need for regulation by imposing market simulating disciplines which in turn would reduce prices for consumers.

The problem was that regulation of privatised utilities confronted many of the same problems as those encountered under public ownership. They were turned into large companies, often exercising monopolistic power, which meant that the performance of the utilities continued to have a vital impact on the nation's economic infrastructure and the broader competitiveness of the national economy. In consequence, any system of regulation had to take account of the obvious public interest in allowing universal access to utility services by controlling price levels and preventing anti-competitive practices. Thus, from the outset utility regulation was required to accommodate often conflicting objectives by navigating a path between social, commercial and environmental considerations. Nevertheless, regulation of some kind was essential since the exercise of monopoly power in the utility sector has many repercussions which relate to the prices consumers have to pay, the level of investment and the standard of the service itself, all of which will have to be controlled to varying degrees.[31a]

Privatisation of state-owned public utilities and transport[32] between 1984 and 1995 changed the industrial structure of the nation[33] and in doing so presented many difficult legal challenges for the Government.[34] In brief, the approach was for Parliament to approve legislation that enabled the Government to transfer ownership of each industry to shareholders, transforming the utilities into autonomous self-financing businesses. On a formal basis this legislation subjected many aspects of the operation of these enterprises to regulation by means of regulatory institutions that were part of the state and accountable to ministers. At the same time, there has been an increasingly significant legal involvement by a process of indirect regulation which relied on drawing up carefully drafted licences and contracts.[35] It has been observed that this meant that the role of the state was recast rather than reduced.[36]

Many of the regulatory provisions were based on a formulation that was established in the Telecommunications Act 1984, although this varied somewhat with each industry. In outline the legislation imposed certain duties in respect of the delivery of the service in question and the statutory regulation of the public utilities[37] but this generally allowed scope for the style of regulation to develop accord-

[31a] See pp 202 ff below.

[32] Eg, gas, electricity, power generation, water services and British Rail. British Telecom is something of a hybrid between these categories, as many of its services have been opened up to wider competition.

[33] Clarke, above n 23, 381; C Graham and T Prosser, *Privatizing Public Enterprises: The Constitution, the State and Regulation in Comparative Perspective* (Oxford, Clarendon Press, 1991).

[34] See A Bradley and K Ewing, *Constitutional and Administrative Law* (12 edn, London, Longman, 1997) 326, 336 *et seq*; and see also T Prosser, 'Regulation, Markets, Legitimacy' in J Jowell and D Oliver, *The Changing Constitution* (3rd edn, Oxford, Oxford University Press, 1994).

[35] Harlow and Rawlings, above n 5 at 320.

[36] W Maloney, 'Regulation in an Episodic Policy-Making Environment: the Water Industry in England and Wales' (2001) 79 *Public Administration* (No 3) 625, 626.

[37] J Burton, 'The Competitive Order or Ordered Competition?: The 'UK Model' of Utility Regulation in Theory and Practice' (1997) 75 *Public Administration* (Summer) 157, 164.

ing to the priorities of the regulator for each industry. Indeed, the lack of regulatory philosophy was recognised as a problem from the outset.[38] It has meant that there has been no standardised regulatory system in the United Kingdom.

The office of the regulator was commonly placed under a statutory duty to maintain a universal service, and in doing so, was required to take into account the social consequences of the operation of the industry. There were primary duties to perform,[39] in particular, the control of pricing levels based on a price-cap formula. This was set at the retail price index minus X amount, the idea being to fix this figure at a progressively lower level as this would operate as a strong incentive to greater efficiency. A duty of equal importance, particularly in view of the wider objectives of the Conservative Government (1979–97), was intervention by the regulator to promote competition, often by the regulator acting as a surrogate form of competition.[40] Many of the economic arguments in support of privatisation were to achieve increases of efficiency, primarily through greater competition. But, as we observed in the introduction to this section, the system of regulation is faced with having to achieve some kind of balance by controlling pricing levels, ensuring access to essential services, protecting consumers, maintaining quality of service, while at the same time promoting competition and now also having regard to the profits of shareholders. This task was and still remains highly problematic because of the need to find a way through potentially conflicting interests.[41] In regard to the utilities, the fact that these are often irreconcilable objectives undermines some of the assumptions which inspired the entire privatisation project.[42] (Later, we shall see that the revised approach to structuring Welsh Water tends to confirm many of the deficiencies in the original privatisations and the same point can be made regarding the relaunch of Railtrack in 2002.)

Constitutional Accountability: Ministers and Regulators

Under public ownership, the state had direct responsibility for the operation of public utilities and there was an assumption that the intervention of government would serve a wider public interest. By contrast, the accountability of ministers to Parliament over the operation of these industries was transformed with privatisa-

[38] Initially, the privatised utilities had regimes of regulation that were based on the Conservative Government's reliance on market models, eg, the formula for pricing under these reports (see S Littlechild, '*Regulation of British Telecommunications' Profitability*) (Department of Trade and Industry, 1984); *Economic Regulation of Privatised Water Authorities* (Department of Environment, 1986).

[39] Thatcher, above n 25, at 125 *et seq.*

[40] The issuing and enforcement of licences will be considered later in relation to gas and electricity. Typically other duties were to oversee standards of service; to ensure that a universal service is provided and to safeguard the right of access for consumers.

[41] We can see that typical choices lie between: (1) promoting short term interests by allowing the distribution of profits to shareholders and a longer term view which demanded investment in an infrastructure; (2) pricing the service at market levels as against the social interest of low prices to protect vulnerable consumers; (3) maintaining a standard universal service and promoting competition by opening up the market (see *Better Regulation Task Force Report 2001*, Recommendations 7(1)).

[42] The collapse of Railtrack during the autumn of 2001 provides an illustration of this.

tion. The privatised structure was devised to avoid certain kinds of direct political interference. However, the fact that ministers performed the pivotal task of issuing licences to these businesses has allowed them to decide the timing, progress and extent of what normally is a natural monopoly and also to determine the progress towards a genuinely competitive environment. Further, it has been suggested that this is consistent with accepted notions of ministerial responsibility.[43] But in constitutional terms it appears that privatisation contributed to a further reduction of ministerial responsibility. Post privatisation, the industries were deliberately distanced from direct ministerial responsibility through the adoption of the status of non-ministerial government departments,[44] most obviously because of the parliamentary dimension to accountability since privatisation placed many more aspects of the industry beyond the routine gaze of Parliament.[45] An effect of the change in status when privatisation took place was to transform the channel of accountability. This change of status prevented MPs from asking parliamentary questions to the minister not only about the industry, but about many aspects of the regulation of the industry.[46] At the same time the role for the subject specific Parliamentary Select Committee on the Nationalised Industries (which operated between 1956–79) disappeared with the introduction of the new departmental select committees. These committees now shadow government departments and not the regulatory bodies, nevertheless the utility regulators have been regularly called to give evidence before departmental select committees and have been the subject of significant investigations and reports, some of which have been highly critical and have suggested reforms to the regulatory structure.[47] The National Audit Office and the Public Accounts Committee also perform an important function in overseeing the role of regulation and regulators.[48]

Ministerial responsibility has been eroded for a number of other reasons. First, the regulator in the form of a Director-General (DG) is appointed by and responsible to the minister. This is under a renewable five-year term but to ensure independence the power to dismiss the DG is restricted to incapacity or misbehaviour, and cannot be exercised merely because the regulator's style is deemed unsuitable or the approach adopted seems to be out of step with government policy. Second-

[43] See CD Foster, *Privatisation, Public Ownership and the Regulation of Natural Monopoly* (Oxford, Blackwell, 1992), 270–71.

[44] Prosser, above n 12, 239.

[45] In some ways there has been more openness since privatisation as a great deal of information is placed in the public domain. However, it should be noted that the Freedom of Information Act 2000 puts commercially sensitive information in a protected category, see s 43(2).

[46] Bradley and Ewing, above n 34, 344.

[47] See eg, the Employment Committee's report on '*The Remuneration of Directors and Chief Executives of Privatised Utilities*' (HC 159, 1994–95) and the Trade and Industry Committee, '*The Domestic Gas Market*' (HC 681, 1993–94). Adam Tomkins ch 3 above, points out that the Hansard report recommends that Parliament should be at the apex of accountability and in this roles it should systematically draw on the investigations of outside regulators and commissions. He also notes that regulators have also welcomed stronger links.

[48] For a recent examples see *Better Regulation: Making Good Use of Regulatory Impact Assessments* (HC 329, 2001–02) and Office of Gas and Electricity Markets, *Giving Customers a Choice of Electricity Supplier* (HC 85, 2000–01).

ly, the introduction of devolution has had an impact, for example, the regulation of Scottish Water under its regulator is not by way of the minister to the Westminster Parliament but to the Scottish Executive and the Scottish Parliament (see later). Thirdly, the allocation of ministerial competences between departments cuts across regulatory issues relating to the energy industry, eg gas and electricity regulators have reported to the Department of Trade and Industry while environmental concerns and energy efficiency are part of the remit of the Department of Environment, Food and Rural Affairs. Fourthly, the legislation is designed in order to restrict direct ministerial involvement since the office of the regulator functions as a non-ministerial government department with the minister unable to interfere with the day-to-day operation of the department.[49] In practice, the Director-General is granted substantial powers which are broadly defined and divided into primary and secondary duties. A particularly important problem has been establishing clear lines of demarcation between the regulator and the minister.[50] Under nationalisation we observed that there was a lack of clarity when it came to distinguishing between policy matters which were regarded as the responsibility of the minister, and operational issues which were dealt with by the Board. Now there is some overlap in relation to the issuing of licences and referrals to the Competition Commission. As we shall see, this lack of clarity has resulted in calls to refine and proceduralise the process of regulation.[51] Such shortcomings have also led to subsequent legislation to correct regulatory failures.[52]

Lastly, it should also be recognised that, at a different level, legal intervention might constrain the regulator. This is in the sense that judicial review, as a remedy of last resort, acts as a threat that will keep the regulator within the bounds of the discretion set out under the statutory framework.[53]

Gas and Electricity Regulation

We will now consider gas and electricity in order to show how strategies of formal regulation have developed in response to changing circumstances and to perceived failures. In view of the problems attached to the provision of utility services[54] it

[49] See eg Electricity Act 1989 ss.11, 12, 23 and 25 and Proser, above n 12, 239.

[50] In assessing the extent of the autonomy of the Director General it is important not to underestimate the importance of the informal contacts and interventions by ministers, including comments on policies that are pursued by the regulator. Although this process often takes place behind the scenes and is difficult to measure, there have been highly visible ministerial interventions, eg John Prescott in regard to the failure of Railtrack to improve the rail infrastructure. (See Thatcher above, n 39, 130).

[51] C Graham, *Regulating Public Utilities: A Constitutional Approach* (Oxford, Hart Publishing, 2000), 32. Such approaches have been discussed at various levels of theoretical abstraction: see eg, J Black, 'Proceduralising Regulation: Part I' [2000] *OJLS* 597; T Prosser, 'Theorising Utility Regulation' [1999] *MLR* 209.

[52] Eg the Water Act 1999, the Utilities Act 2000 and introduction of the Strategic Rail Authority under the Transport Act 2000.

[53] Prosser, above n 6, 94.

[54] W Hutton, *The State We're In* (London, Verso, 1995), 217 *et seq.*

was obvious at the outset that these industries could not be simply privatised without regulation. Furthermore, the need for regulation has not diminished post privatisation[55] and accountability[56] under current conditions of governance has to be linked to the effectiveness of regulation.

Regulation has remained an important means for the government to achieve its policy objectives[57] and these powers have been strengthened by the post 1997 Labour Government with the introduction of new forms of additional regulation.[58] In some respects this has become more specialised with greater complexity and formality but approaches have become increasingly informal in others ways too. This will be particularly apparent in the later sections of this chapter (See under Regulators 'Joining Up'). Also, there has been a growing emphasis on co-ordination, for example by the use of concordats and a committee co-ordinating the work of regulators. However, as will become clear, the devolution arrangements only partially address the issue of cross-border regulation and between the many different bodies involved.[59]

From the outset there were contrasting approaches to gas and electricity privatisation and regulation. The initial arrangements for gas privatisation were modified in response to criticism over the lack of competition which can be attributed to the way the UK gas industry had been privatised by the Gas Act 1986 as a single entity. The problem was that British Gas was not broken down into 12 regional gas companies, which would have encouraged greater competition. This option was chosen because in the short term it could have had damaging political consequences by increasing the cost of gas to consumers and slowing down the Government's privatisation plans.[60] The original privatisation empowered the Secretary of State after consultation with the Director-General to authorise the public supply of gas by issuing a licence,[61] and the regulator was made responsible for policing the licensing arrangements.[62] Furthermore, the minister was able set targets for competition.[63] The Act

[55] The failure to set in place regulation following bus privatisation has meant an unchecked decline in standard and frequency of service delivery and in safety. See W Hutton, *The State to Come*, (London, Verso, 1997), 20.

[56] Accountability in this context can be broadly defined as 'an obligation for a person or organisation to justify actions to another body in terms of some authorisation for the activity given by that body including assignment of duties or purposes, answerability, overseeing performance, incentives for good performance and penalties for inadequate performance.' See O James, 'Regulation Inside Government: Public Interest Justifications and Regulatory Failures' [2000] *Public Administration* 327, 328.

[57] C Harlow and R Rawlings, above n 5, 295.

[58] The reform of the Post Office is the latest example of this. See *Post Office Reform: A World Class Service for the 21st Century* (Cm 4340, 1999) and the Postal Services Act 2000. Postcomm, the industry regulator under the Postal Services Act, published its decision on the introduction of competition for the UK postal market on 29 May 2002.

[59] White Paper, *Modernising Government* (Cm 4310, 1999). Regulation continues as a priority in latest UK government thinking, with an emphasis upon comparing the performance of public bodies against 'quality' systems in the private sector.

[60] P Craig, *Administrative Law* (4th edn, London, Sweet & Maxwell, 1999), 349 *et seq.*

[61] See Gas Act 1986, ss 7 and 8.

[62] This power has now been conferred on the regulator but with the minister retaining a power to determine the conditions: see Gas Act 1995 s 8 and Utility Act 2000, ss 33 and 34.

provided a complex formula for pricing which had to be agreed with the Director-General of Gas Supply. However, the channels of control and accountability were significantly modified by the conferment of private sector status, in that the Gas Act 1986 conferred primary duties on the Director-General (and not the minister). These were first to ensure that the supply of services met all reasonable demand; secondly, to ensure that suppliers were able to finance the provisions of their services; and thirdly s/he was required to promote competition.[64] However, a serious flaw was that the Director-General was not given power to change the legal structure of the industry, in particular to introduce competition[65] and the Director-General could only encourage effective competition in gas supply for consumers above a certain volume which was exclusively to the benefit of large commercial users.

The concerns that had been raised over gas contributed to a different approach when it came to privatising the electricity industry. The state generating company was broken up into National Power, Powergen and Nuclear Electric. Transmission was left in the hands of the National Grid, but the 12 regional supply companies for England and Wales were transferred to the private sector as separate companies.[66] Such an approach was in line with the essential facilities doctrine which tackles the problem of how to introduce competition without duplicating existing infrastructure. This goal is achieved by setting out rules that allow competitors to have access to these facilities and the next stage is to enable competition to take place between existing and new operators.[67]

Regulation of the electricity sector under the Electricity Act 1989 was granted primarily to a Director-General of Electricity Supply who was given broadly similar primary and secondary duties to other regulators. However, one of the most important powers—namely, that of licensing—was shared with the Secretary of State. The minister was granted a power of veto over any modifications to licences.[68] This turned the Secretary of State into the licensing authority by making it possible for him or her to intervene in the work of the regulator, first determining the degree to which competition would be encouraged by deciding upon the number of licences to be issued and second by setting the licensing conditions themselves.[69] However, this remained a power to issue rather than enforce licences (this power remained with the regulator).

[63] In practice, ministers have continued to play an active part. For example, Peter Hain, as Energy Minister, intervened at a political level on Ofgem's behalf in later March 2001. This was after OFGEM was obliged by the Competition Commission to remove the market abuse licence condition (MALC) which had been intended to be written into contracts to prevent abuse of market power. It was recognised that failure to include this could undermine the regulatory process.

[64] In addition, there were a number of secondary duties which included promoting and protecting the interests of consumers in relation to pricing; preventing dangers from gas transmission and protecting the environment.

[65] Prosser, above n 6, 93

[66] M Grenfell, 'Can Competition Law Supplant Utilities Regulation' in C McCrudden, *Regulation and Deregulation: Policy and Practice in the Utilities and Financial Services Industries* (Oxford, Clarendon Press, 1999), 222–23.

[67] *Ibid* at 225.

[68] Electricity Act 1989, s 6 allows the minister to delegate the power to the Director-General of Electricity Supply.

[69] Prosser, above n 6, 47.

The decision to liberalise the market in the gas and electricity sector by allowing the domestic customer to chose between suppliers was a very significant change of policy. A critical Competition Commission report prompted further legislation in the form of the Gas Act 1995,[70] which imposed a duty on the Director-General to promote competition by opening up the domestic gas market. This was achieved by splitting up the production and distribution and thus making access through pipes owned by British Gas available to any licensed supplier. At this point, the Secretary of State and the Director-General were made responsible for drawing up more detailed rules for the new system. This was by a process that has been termed 'administrative decision-making'.[71] The upshot was that this introduced an element of competition that had been absent from the original privatisation arrangements. Customers were offered the prospect of a reduction in the price of their energy bills but this coincided with a relaxation in regulatory conditions that potentially allowed for variations in pricing on a regional basis.[72]

This incidentally had an unexpected implication, since it also meant that another form of regulation was needed for a different and unforeseen purpose, namely the protection of customers from being tempted into unfavourable deals from new suppliers, who were using unscrupulous methods to mislead the public when inducing them to change from their original gas or electricity provider. As a result of the concerns that were raised, trading standards officers were brought into the process of regulation and consumers were given consumer guidance on the Internet as to the relative merits of the deals on offer.[73]

It should also be remembered that another dimension to regulation is achieving the desired distribution of benefits between different categories of consumers.[74] This can result in the multi-layered involvement of regulators and has been apparent with references from the Office of Fair Trading (OFT) to the Competition Commission (formerly the Monopolies and Mergers Commission) over pricing policy. For instance, the Competition Commission makes an important contribution to the process when the pricing formulae and other licence modifications cannot be agreed by the regulator and the service provider. In this context, the Competition Commission not only has an adjudicatory role but plays a part in setting out future guidelines for pricing. The Competition and Services (Utilities) Act 1992 should also be mentioned since this strengthened the powers of regulators on matters of quality, enabling them to set out standards of supply, reliability and customer service. This legislation introduced

[70] Amendments to the Gas Act 1986 followed the report: Monopolies and Mergers Commission, *Gas* (Cm 2314, 1993).

[71] Graham, above n 51, 175 *et seq.*

[72] *Ibid* at 176.

[73] The Office of Fair Trading website provides consumer guidance on the relative merits of the deals on offer. See eg, http://www.energywatch.org.uk

[74] See Prosser, above n 6, 273 for a discussion of the role of the Monopoloies and Mergers Commission (MMC), now the Competition Commission. It was supposed that this role would diminish with increasing competition but there has been little sign of this happening. The Competition Commission is an independent public body established by the Competition Act 1998 and it replaced the MMC on 1 April 1999. Competition Act 1998, s 54 and Sch 10 now determine the Commission's role in regard to utility regulation.

Citizen's Charter values across the utility sector in an attempt to achieve guaranteed standards of service.

REGULATION AND NEW LABOUR: CORRECTION, REPAIR AND CONSULTATION

When Labour was elected in 1997 it was confronted with a number of problems that arose from previous privatisations. For instance, the Labour Government's subsequent attempts to improve regulation have been undertaken against a background of falling standards of service in parts of the sector (eg British Gas lost its Charter Mark and the rail industry has lurched from crisis to crisis). Although Labour was careful to avoid a specific commitment to return any industry to public ownership it modified existing schemes of regulation in response to perceived failures and assumed a much more active role in social and environmental matters.[75] Another prominent feature of this most recent phase of regulation—which is a major concern for this discussion—is that it has a multi-layered character which has become increasingly evident. It has been noted that 'while several agencies were involved in the regulatory process prior to privatisation, this regime was less complex (and less rigorous) than the post privatisation structure'.[76] Accordingly, in the current situation we need to understand the relationship between different layers of government and the relationship between a range of different regulators. An equally important issue for regulators has been the need to undertake their task with a lack of integrated information upon which to base their decisions.

Utilities Act 2000: Statutory Refinement of UK Energy Regulation

The lack of uniformity in the approach to the regulation of gas and electricity, already discussed, is addressed by the Utilities Act 2000 which applies to England, Wales and Scotland. It provides a single regulatory authority for both industries and in setting out to promote effective competition it is intended to reflect increasing convergence between the two industries. This is already very evident from the interpenetration of utility companies with interests in gas, electricity and water in various combinations. However, the role of the new regulatory authority, Ofgem, reaches beyond a purely economic agenda and the Utilities Act differs from previous legislation by placing much greater emphasis on protecting the interests of consumers. For example, under section 13, the Act contains provisions to enable the gas and electricity sectors to make an appropriate contribution to the govern-

[75] See White Paper, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation* (Cm 3898, 1998) and Graham, above n 51, 61 *et seq.* See later section on 'Environmental Regulation of Water'.

[76] Maloney, above n 36, 630.

ment's social and environmental objectives.[77] The Secretary of State has new powers to intervene to adjust charges to help disadvantaged groups.[78] For example, this could be exercised if one group of consumers is treated less favourably than others.[79] In addition, sections 44–50 placed increased restrictions on disconnecting consumers.

In terms of our multi-layered model it is relevant to note that one of the reasons for further regulation is that in the energy sector the government has had to respond to initiatives originating from the European Commission.[80] This is conducted, in part, through powers that are exercised by the Director-General of Fair Trading and now the Competition Commission, concerning in particular intervention to prevent anti-competitive agreements and the abuse of market dominance. The Utilities Act 2000 modifies the structure and regulatory regime for the gas and electricity sector to facilitate further competition in line with EC directives which require that Member States create appropriate mechanisms for regulation to achieve 'competition in generation; a limited form of competition in supply; and unbundling.'[81] It achieves this, as was mentioned earlier, by giving the Competition Commission a significant role in the regulatory process. The Commission has concurrent powers of enforcement with sectoral regulators. In consequence, overlapping layers of formal regulation, both from Europe and through the intervention of other domestic regulatory institutions illustrate the multi-layered nature of the current system.[82]

The Utilities Act 2000 also introduces alignment of the licensing and regulatory systems for gas and electricity (for example by including the concept of standard conditions for electricity licences). Each licence has an accompanying set of standard conditions which set out the obligations and duties that each licensee must adhere to. The Act gives the Gas and Electricity Markets Authority (OFGEM) power to grant licences for gas and for the generation, transmission, distribution and supply of electricity,[83] but the standard conditions of any licence are determined by the Secretary of State.[84] Any such conditions may be modified by

[77] See section 70 and 99. The regulator has published a succession of Social Action Plans. For example, newsletter for Social Action Plan No 5 (June 2002) refers to best practice in delivery of energy efficiency advice, debt collection, providing an information campaign for pensioners and promoting awareness of energy issues.

[78] Utilities Act 2000, section 69 and section 98.

[79] C Graham, 'The Utilities Bill' (2000) 11 (3) *Util Law Rev* (May-June) 101.

[80] See EC Directive 96/92 for electricity; and 98/30 for gas.

[81] Graham, above n 51, 122.

[82] It is interesting to compare the French approach to opening up the gas market in response to the EC Directive 96/92 which also involves creating a common regulatory body for electricity and gas 'Commission de Regulation de l'Electricite et du Gaz' (CREG). See Du G Puy-Montbrun and B Martor, 'French Electricity and Gas Regulation' (2000) 11(6) *Util Law Rev* 11 190, 191, who point out that the majority of regulatory powers remain in the hands of the French government, through the Minister for Energy; but the CREG may through its opinions and decisions set the framework for the French regulatory system. These powers are described as minimal in comparison with the United Kingdom, especially as it is the Energy Minister who remains in control of price levels.

[83] See Utilities Act 2000, part IV and part V.

[84] See Utilities Act 2000, s 33 for electricity and s 81.