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Who Are Our Economic Regulators?

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Most people working in the energy and water industries will be familiar with the work of the regulators Ofgem and Ofwat. My guess, though, is that only a small minority will know that the regulators' legal decision-making powers are vested in bodies called the Gas and Electricity Market Authority (GEMA) and the Water Services Regulation Authority (WSRA), respectively. At a time of ongoing public debate about the quality of economic regulation, this feels like an under-discussed issue, for the reasons I explore in more detail below.

History

When economic regulators were first introduced in this country in the 1980s and 1990s, the regulators in most[1] of the UK's regulated sectors were formally individuals with titles like the Director General of Telecommunications Services or the Director General of Electricity Supply. It was, however, recognised from the outset that regulation would be more than a one-person job and so the early appointees – people like Bryan Carsberg, Stephen Littlechild, Iain Byatt and Douglas McIlldoon – were permitted by law to recruit staff to support them. This created the forerunners of the offices that we know today as Ofcom, Ofgem, Ofwat, the NI Utility Regulator, the Office of Rail and Road, and the Water Industry Commission for Scotland.

The ten years or so after the first privatisations were generally a successful period for regulation and for the UK's regulated sectors. But there were rough edges. When the last Labour government came to power in the late 1990s it committed itself to a full review of the legislation that the previous Conservative government had established, with a view to obtaining what it termed a "fair deal for consumers" and "securing a long-term, stable and effective framework that safeguards the interest and consumers alike".[2]

Once finalised, one of the main changes the review produced was to switch from individual regulators to new regulatory boards (e.g. the aforementioned GEMA and WSRA). The stated intention was to depersonalise regulation after what had felt like overly personalised battles during the early years of regulation, and in doing so hopefully rein in some of the more extreme positions that regulation by one person had sometimes seemed to generate.

The original proposal was that boards should comprise three people. However, when the government in 1999 published the Utilities Bill that eventually created GEMA, it changed its mind and decided that the Secretary of State should be able to appoint a bigger slate of board members. The government subsequently took a similar approach when switching over all of the other regulators, providing in law that each regulator:

> … shall consist of a chairman and at least [n] other members appointed by the Secretary of State

or words to that effect.[3]

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[1] The exception was the Civil Aviation Authority which from the outset was a body corporate.

[2] https://publications.parliament.uk/pa/cm199798/cmselect/cmtrdind/747/74704.htm

[3] See Schedule 1 of the Utilities Act 2000, section 1 of the Office of Communications Act 2002, Schedule 1A of the Water Industry Act 1991 (as amended), Schedule 1 of the Railway and Transport Safety Act 2003, Schedule 1 of The Energy (Northern Ireland) Order 2003, Schedule A1 of the Water Industry (Scotland) Act 2002 (as amended), and section 2 of the Civil Aviation Act 1982.

Current situation

The changes made to sectoral legislation 20-25 years ago remain in place today. What we now see in most sectors, in practice, is boards of 6-10 people composed predominantly of 3-days-a-month appointees (i.e. so-called "non-executive directors") and sometimes as few as one full-time executive member (e.g. the Chief Executive).

I have always found this curious because nowhere in the relevant pieces of legislation does it say that our regulators should be part-time appointments. Indeed, the concept of a "non-executive" director does not appear in most of the relevant Acts. What the law does say is that Parliament vests formal decision-making powers in a defined group of individuals – NB: not in the offices that support them, but in the particular group of people that the relevant Secretary of State hand picks to *be* the regulator.

Assessment

To the best of my knowledge, there was never a point at which policymakers discussed and agreed that a non-exec-led board was the optimal template for economic regulation. So is this set-up actually conducive to good regulation? My view, as a boots-on-the-ground regulatory practitioner, is that it is not.

I do not think it is controversial to observe first of all that a regulator cannot reasonably be expected to make considered decisions if he or she only works 3 days a month. It is not surprising, therefore, that the job descriptions that we see published for board members normally emphasise the role that non-executives can play in "challenging" and "supporting" the executive rather than on inquiry, evaluation and decision-making per se – an arrangement that tips the statutory scheme on its head.[4]

In my experience, though, even this is a considerable stretch. To be able to challenge and support effectively requires a certain level of knowledge of the subject matter that often cannot realistically be accumulated on only a small number part-time hours. Without the requisite background, my experience is that the discussion at regulators' boards can, at worst, be very erratic and, at best, focus more on the process that the staff have followed in order to come to a decision than on the substance of the decision itself.

There is also then a question about accountability. People given powers as expansive as our regulators ought to be asked periodically to explain and account for their decisions. But most of the statutory decision-makers are close to invisible: non-executive directors rarely meet with persons affected by their decisions; they do not appear in front of the CMA during appeals; and they do not attend Parliamentary Select Committee hearings.

In my opinion, therefore, the non-exec model is a definite fault line in modern-day regulation. Parliament is entrusting regulators with decisions that have consumer impacts running into billions of pounds, but Secretaries of State are not, for the most part, appointing individuals to regulators' boards with the requisite time and the requisite expertise to make the right judgments. This may not necessarily have serious consequences when a regulator is lucky enough to have a very capable staff. But in situations where, for whatever reason, the executive is more dysfunctional, I have seen on multiple occasions how the quality of decision-making can decline.

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[4] See also para 5.4 of Ofgem recent evidence to the House of Lords Industry and Regulators Committee: https://committees.parliament.uk/writtenevidence/127149/html/

The remedy

What is the alternative?

My advice to anyone who is contemplating possible regulatory reform at the moment is that one of the things that the government can do in order to improve economic regulation is to switch back to the design mooted 25 years ago in which regulators' boards comprise three (or four or five) full-time or near-full-time members. I would also like to see Secretaries of State appoint individuals with genuine expertise into these roles, whether gained from time spent working in an industry or in the field of regulation.

A change of this type would right a clear and obvious wrong in the current system. It would deepen the pool of expertise that is going to be needed as regulators navigate choppier waters in the years ahead. And it would ensure that decisions are taken in a considered way, with proper checks and balances and proper accountability afterwards.

More than anything, it would reflect a recognition that good regulation and bad regulation more often than not arise because of people. If we want the best out of our regulated companies, we need our regulators to be headed by more than 3-day-a-month appointees.

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