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The role of UK competition agencies in the regulation and deregulation of utility service industries: reflections of a former regulator

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Abstract

During my time as Director General of OFWAT, my relations with the Office of Fair Trading and the Monopolies and Mergers Commission (MMC), now the Competition Commission (CC), primarily covered:

– Appeals to MMC/CC against price determinations.
– Merger cases involving OFT (where water: mergers were a compulsory reference).
– Competition Act cases (none in my time as regulator). But we needed to be clear about how concurrent powers would work. It was important to issue early guidelines so that suppliers and potential suppliers should know where they stood.

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1. Appeals

I begin by arguing that it is essential that there should be scope for appeal on price determinations and on licence amendments. (Note the difference between water, telecom and energy, rail and airports as far as appeals on price setting are concerned. I think the water model is to be preferred.) The CC should have the last word, subject to details of drafting on licence amendments and Judicial Review.

An appeal body should be technically competent. The CC scores well here, although I should like it to pay more attention to the general approach to regulation (methodology) and rather less to the (deeply delved) details of an individual case. I should have liked to see more evidence of a "utility panel".

There are important strategic differences as well as similarities between the different utilities—between utilities where competition is easier (telecom and energy) and where investment is more of an issue (water and transport). In my view, these issues come first, numbers second.

In the price determination cases I was involved in, the CC plunged quickly and deeply into the detail of the individual case. I would have liked to see more consideration of whether the primary regulator had a good approach and whether it had been properly applied in the circumstances and when it came to numbers, more of a 20/80 approach.

The Courts are deficient as an appeal body not only in technical expertise, but also in a balanced economic approach. This, I believe, was demonstrated in the Judicial Review judgements firstly, on Budget payment devices and, secondly, on the definition of estuaries. As the CC is the appeal body, the issue—unlike as in the US—is the quality of judicial review. It would be inter-

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esting to see a comparative analysis based on all the judicial review cases in the utilities area.

The general danger in regulation is of excessive detail, particularly too much delving into inputs—and in some cases into precise outputs. The more regulation can be related to the better outcomes (for instance, the Isle of Wight sewage treatment after the 1994 price review, where the whole approach to improving quality went wider than considering individual works).

It is also desirable for regulators to avoid delving into management. The dividing line between management and regulation is not always easy to draw, but it must be done if incentives to efficiency and good performance for customers are to be retained.

For both these reasons, I think it is most important for a price determination to be regarded as a package, not subject to line-by-line appeal. Line-by-line appeal will intensify any tendency to line-to-line regulation. An appeal, for example, on a single issue, such as the cost of capital would not be sensible, nor, I think, practicable.

I do not believe other parties should be able to require an investigation by the CC. Nor do I believe that companies should get an automatic reimbursement of their costs as they did in the Sutton and Easy Surrey and Mid-Kent cases. This was, to my mind, the only really bad decision the CC took on a water matter during my term of office.

2. Mergers

The "management" of mergers involved close working with the OFT before any decision to refer was taken (except water, where references above a threshold were compulsory).

This was a question of sensible joint working. The OFT had the legal powers. The sector regulator had the industrial expertise. The situation soon settled down, but the statute was rigid and without goodwill on both sides could have resulted in inter-agency disputes.

Where small water: water references were concerned, there was an easy exchange of views and information between OFWAT and OFT. In practice OFWAT was in the lead.

Where non-water: water mergers were concerned, a good process developed, whereby the water regulator issued a consultation paper, on the basis of responses—and regulatory consideration—made a recommendation to the DGFT. DGFT relied heavily on DGWS in making a recommendation to the Secretary of State for Trade and Industry. This will change under the Enterprise Act 2002, but not perhaps much in economic, as opposed to legal, substance.

When mergers were referred to the CC, OFWAT gave evidence, mainly on the value of a comparator but also on how comparators were used throughout the regulatory process. In two cases, 3 Valleys and Northumbrian, the SoS looked to OFWAT to implement a recommendation by the MMC. (In the case of Northumbrian the MMC recommendation was that OFWAT should discuss a remedy with the Secretary of State. This was also a merger that had to be considered with respect to European Commission (EC) guidelines. And in one case, Southern, the Secretary of State discussed the decision with OFWAT after a divided CC recommendation.

This will now change. The CC will need to consider remedies. To what extent will it consult with the primary regulator? Will this involve a further stage in an inquiry, once the yes/no decision has been taken? What will happen in the case of EU mergers that fall within the EC's remit? It will be necessary to see how the future EC merger arrangements settle down in practice.

How an appeal to the Competition Appeals Tribunal would work in practice is an important matter. In my experience, there is considerable and desirable scope for pragmatism.

3. Competition Act 1998

My first objective—putting life into concurrent powers—was to establish joint working with the OFT. This meant devising OFWAT guidelines for water and sewerage and getting them incorporated into the general run of OFT guidelines. Other than enduring the tedium of discussions on drafting—necessary but not enjoyable—this was a painless process.

The role of the Competition Appeals Tribunal (CAT) will be important. I am aware of several proceedings in a number of industries, including water. The only CAT ruling I am familiar with is that relating to Freeserve's complaints about the behaviour of British Telecom (BT) in the broadband market.

The CAT set aside one (perhaps two, depending on how you do the counting) of four, or five, of the decisions of OFTEL, the telecommunications regulatory agency. It also gave some indication of how it would approach cases.

Its general approach:

- picks out the importance of the reasons given for the Director's decision;
- states that the CAT will normally consider only the evidence presented at the first stage, but will not be restricted to this.

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The decision of the CAT puts considerable emphasis on the quality, and the fullness, of the Director's reasons. This is an interesting contrast to the position of the 1980s, when Bryan Carsberg (the first Director General of OFTEL) was, I understand, advised not to give too full an explanation, lest he should be taken to judicial review.

In future, regulatory decisions will need to be more fully argued and documented. We will have to see how that affects the speed of decision-making.

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