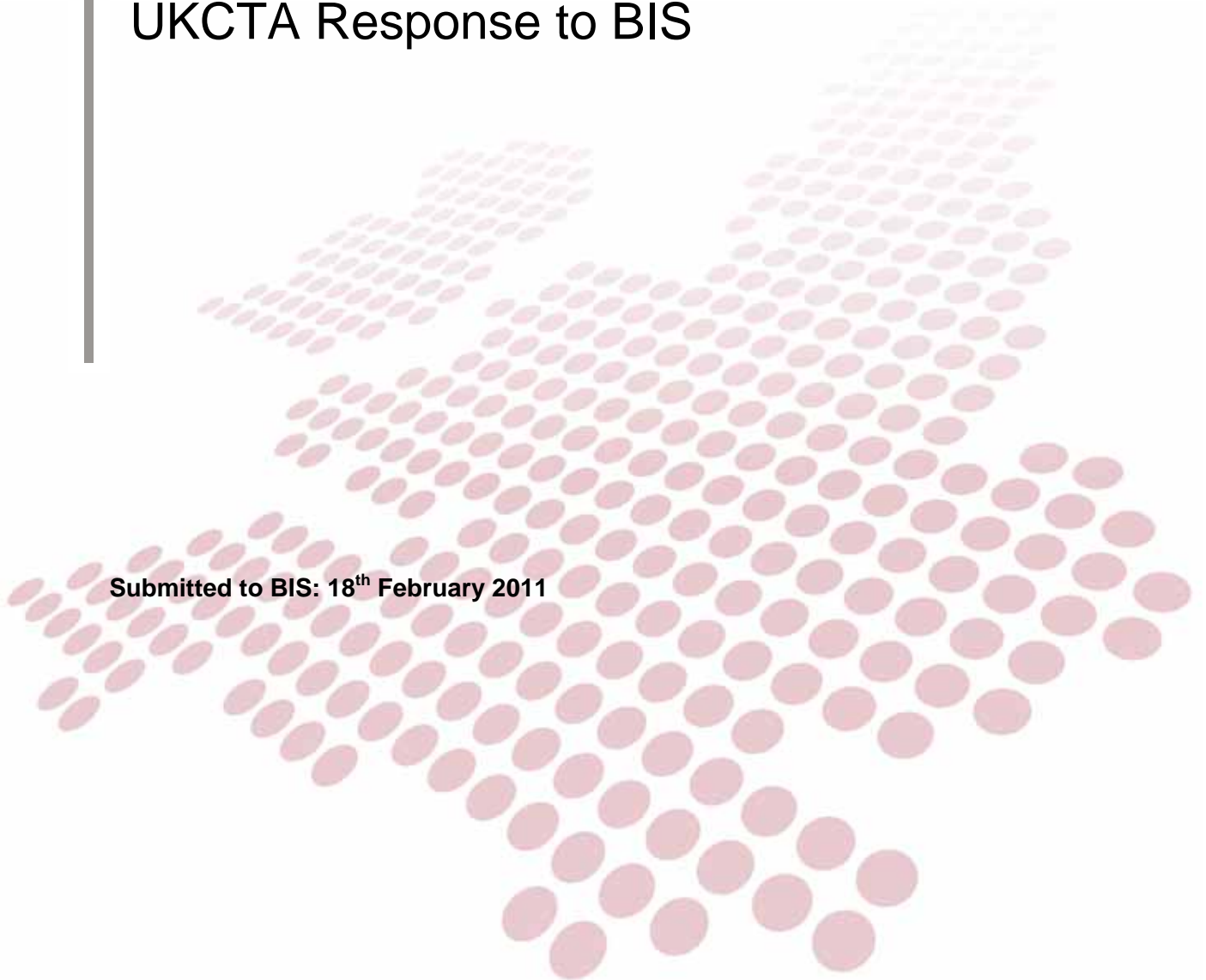


# Principles for economic regulation

UKCTA Response to BIS

Submitted to BIS: 18<sup>th</sup> February 2011



UKCTA is a trade association promoting the interests of competitive fixed-line telecommunications companies competing against BT, as well as each other, in the residential and business markets. Its role is to develop and promote the interests of its members to Ofcom and the Government. Details of membership of UKCTA can be found at [www.ukcta.com](http://www.ukcta.com).

This response is focused upon BIS's Call for input into a framework for Economic Regulation. We welcome this consultation, believing it helpful to have a common framework on which to assess matters of economic regulation.

### **The need for robust regulatory accounting**

UKCTA believes a well functioning freely competitive market is the best way to deliver efficient and innovative products to the market. Trying to recreate outcomes akin to a competitive market in cases of market failure, where one supplier has significant market power is far from straightforward. In UK telecoms there have been protracted discussions around the production of accurate BT cost information. Since 2008 BT has not only taken the extraordinary step of re-stating its regulatory accounting information due to inaccuracies, it has also increased its own network valuation by £1.8BN, following its arbitrary decision to change a background assumption on network build costs. Such changes result in an increase in underlying costs which are passed on in wholesale charges. Ofcom plan a more fundamental review of regulatory accounting, but when we are discussing the fundamentals of economic regulation we can't decouple the debate entirely from regulatory accounting. Unless economists and regulators have sound and accurate data on which to base decisions, then we can't expect them to deliver outcomes that mimic competitive markets, instead we will have to live with sub-optimal outcomes that favour the incumbent and are to the detriment of competitors and ultimately consumers.

### **One size doesn't fit all**

While we welcome dialogue between different UK sectoral regulators to help promote best practice and drive improvements, such cooperation must not prevent sectoral regulators from choosing the best way forward for their industry. That doesn't mean best practice and thinking can't be shared between regulators, it just means that there should not be an

expectation that each regulator should follow the same path when considering the same issue, as the industry context and indeed the legislative regime governing each sector are likely to be different.

### **Improving Transparency and securing the right of appeal**

We agree whole heartedly with the view that regulators should be subject to scrutiny and be required to answer questions from stakeholders. The answers provided should be meaningful and provide enough detail to enable stakeholders to comprehend the issues and the rationale behind any proposed changes or decisions. A greater level of transparency, particularly when dealing with charging and costing issues around the supply of SMP services, might avert future appeals, promote understanding and therefore enhance decision making as a result of a more transparent consultative process. The use of confidentiality rings in some circumstances would be a sensible way to deal with certain confidentiality concerns.

### **Efficiency**

In the absence of a competitive market a supplier who has market power has little immediate incentive to operate in an optimally efficient way. Usually these suppliers continue to suffer from the hangover of inefficient practice stemming from former state ownership; this is often particularly true in attitudes towards industrial relations. Such circumstances mean that inefficiencies are passed on to consumers through higher charges. While regulators are vocal in their opposition to inefficiency, they often fail to take action to tackle some of the fundamental contributing factors. While charge controls conceptually promote efficiency, with a regulated entity able to keep any surplus efficiency improvements during the life of the control, the boundary line of what is considered efficient can be drawn in the wrong place, leading to prolonged inefficiency in the supply of regulated products.

In the future regulators should rely less upon a regulated entities own cost information, rather they should make more use of competitive benchmarking to ensure that efficiency targets are realistic and based on a wider frame of reference, preventing regulated providers from surcharging competitors and consumers as a result of their own inability to tackle their inefficient industrial relations practices.

## 1. Q&A

**Q1** *Do these principles sufficiently encapsulate the characteristics of a successful framework for economic regulation? If not, how could they be improved?*

The principles of Accountability, Predictability, Coherence, Adaptability, Efficiency and Focus are all sound guiding values to adhere to. The interpretation and application of the principles are as important as the principles themselves, with regulators needing to act with integrity when deciding the emphasis to place on each principle in any particular case.

**Q2** *Would their application deliver greater clarity about the respective roles of Government, regulators and producers, and greater policy coherence, and hence reduce uncertainty generated by the lack of clarity?*

The application of the principles would greatly improve the frame of reference available to all regulators. The principles should be a starting point, assisting regulators, government and stakeholders, helping to explain the general approach that should be adopted. We caution against a one sizes fits all approach to regulation and the principle of adaptability has to be adhered to, as it is perfectly possible for two different regulators in different industries to correctly reach different conclusions on the same issue because the industry context is different.

**Q3** *Is the division of responsibilities, currently divided between regulator and Government, sufficiently clear?*

- *Does the regulatory framework allocate responsibilities to regulators that are inherently political in nature and which should be taken by Government?*
- *Are there areas where the Government should set back, having set out its objectives, and leave the regulator to take decisions?*

In the communications industry the regulatory framework is sufficiently clear to delineate the boundaries between Government and Regulator. The common EU framework also helps to make this distinction clear. Where the boundary becomes blurred, is when a particular government policy agenda is introduced and Government expects the regulator to work

towards it. Where ever possible Government should take a step back and let the independent regulator interpret the revised government policy objectives and implement any new objectives in an appropriate way. Direct Government intervention is generally unhelpful; instead regulators should be allowed to get on with the task of regulating with reference to statute.

**Q4** *How clearly is the division of responsibilities articulated, for example through statutory duties, in a way that provides the necessary focus?*

- *Are regulators' duties easy to understand and clearly prioritised?*
- *Is the range of issues regulators are required to consider too broad?*
- *To what extent should regulators' duties be more outcomes focused and avoid specifying means, tools or inputs to achieve policy goals?*

Regulators can always do more to help stakeholders understand their duties and priorities. The appeals history in the communications sector has helped Ofcom get a better grasp of how to interpret its duties and what is expected of it in a particular sets of circumstances. Some effort is made by Ofcom to set out what its priorities are for the year ahead, such as the publication of an annual plan, however in a fast moving environment events can often overtake regulators and it would be desirable to have a more dynamic view of regulatory priorities. That said, any reporting mustn't get in the way of regulating and as such any reporting must be proportionate.

**Q5** *To what extent is the decision making of regulators sufficiently transparent (for example in consultation practices, publication of the reasons for decisions and accessibility of tools and models) to enable sectors to predict likely outcomes and scrutinise decisions?*

In the communications sector Ofcom is currently considering how to improve transparency following criticism in some recent appeal judgements. In the past stakeholders have not had sufficient detail and have had to place considerable trust in the regulator in order to secure the correct outcome.

**Q6** *Are the existing appeals mechanisms appropriate, in terms of the:*

- *Bodies with the right to appeal/object*
- *Appeal-hearing body*
- *Basis of appeal*
- *Role of government*

In terms of the Communications sector, we believe that the existing appeals mechanism is appropriate. UCKTA strongly supports the current standard of a full merits appeal for the majority of appeals under the Communications Act. Whilst recognising that other regulatory sectors may be subject to a different standard of appeal, UCKTA believes that shifting from the current standard of a full merits appeal to a judicial review standard, would in fact create rather than minimise regulatory uncertainty within the communications sector. UKCTA refers to its submissions on the Government's consultation on implementing the Framework Directive for more detailed comments on why the current standard of review should be retained.

UCKTA also supports the role of the Competition Appeals Tribunal (CAT) and the Competition Commission (CC) as the appellate bodies for appeals under the Communications Act. UCKTA believes that the specialist economic and other skills available to both the CAT and the CC and the fact that the bodies deal with a limited number of types of appeal ensure a detailed and effective review process. Any suggestion that these appeals with their often highly detailed economic and technical evidence could be heard as effectively in the Chancery Court UCKTA believes is unsustainable.

The CAT has heard a large number of appeals from stakeholders about Ofcom decisions and has developed and continues to develop a comprehensive body of case law both on substantive and procedural aspects. This body of judicial decisions is crucial guidance for stakeholders considering mounting an appeal. Similarly the Competition Commission has had a number of price control matters referred to it from the Competition Appeals Tribunal for determination and again has developed a body of procedural and substantive precedent. It has recently conducted a review of the way in which it deals with price control matters and has published a consultation on revised guidance. UCKTA welcomes the CC's willingness to subject its own processes to scrutiny and its willingness to engage with stakeholders to bring about improvements to its processes.

A move away from either the current standard of review or towards different appeal hearing bodies would in UCKTA's view undermine the progress that has been made to date in developing this body of precedent at both the CAT and the CC level. The initial appeals

under the new regime would almost certainly take longer as a new body of procedural guidance was developed.

Finally UKCTA has clear views that Government's role in any appeal process is only to support the appeal process by ensuring that adequate resources are available to the appellate bodies. Other than that Government has no role to play in an appeal process which must by definition be independent of Government and the regulator. In relation to the issue of resources, UKCTA notes that it has been suggested that the CAT should be merged into the broader Tribunal's service. UKCTA notes that the CAT has so far managed its limited resources in an extremely flexible way to handle a large body of casework in an efficient manner. Any reduction of this flexibility through the imposition of greater administrative controls and centralisation would be in UKCTA's view a retrograde step.

**Q7** *How effective are the mechanisms to review the operation and delivery of economic regulation?*

- *Should periodic reviews of sector regulation and the role of the regulators be undertaken, to identify possible areas for improvement and provide greater confidence in the framework?*
- *Who should undertake such reviews? Should they be by an independent third party, for example, to provide an external challenge and how frequently should they be undertaken?*

UKCTA would support more frequent external scrutiny of regulators by suitably qualified bodies. Such audits should consider the application of economic regulatory objectives within their scope. These external audits would compliment the appeals process, introducing the necessary checks and balances to help secure a high quality regulatory process.

**Q8** *What is the optimum way of balancing the need to make the frameworks stable and predictable, coherent with broader public policy and able to adapt to changes in sectors and technologies?*

- *What effect has the evolution of regulators' responsibilities had on the predictability of the framework and the attractiveness of the sectors to investors?*
- *How effectively does Government articulate the broader policy priorities under which regulators carry out their statutory functions? What is the impact on regulatory decision making and does this deliver a coherent overall regime?*
- *How effective have changes to statutory duties been in adapting the focus of regulators to emerging priorities?*
- *What restraint should Government impose on itself in the frequency of changes to the framework and policy priorities?*

- *Would a more formalised, pre-announced process (such as a Government strategy statement) for articulating policy priorities, reviewing the effectiveness of regulation and implementing changes on a cyclical but infrequent basis be beneficial in balancing these three principles in particular?*

There is no simple answer to this question. It is our belief that in the UK communications sector the transition to the 2003 framework did not discourage investment, as the transition for the most part was sensitively handled and did not result in any significant market shocks. Regulatory frameworks should not become obstacles to progress or advancing technology, so while it may be desirable to give investors certainty on some aspects of their investment, a regulator cannot and must not attempt to insulate market participants from all risks. A regulated entity making a substantial new investment should be allowed to make a reasonable return from that investment, but at the same time regulators must not guarantee those returns, instead they should strive to provide a degree of stability, remaining technology neutral, not prejudging consumer decision making. Likewise competitors must be given access to wholesale regulated products at reasonable prices to ensure wide consumer benefit.

**Q9** *Are there sufficient and efficient mechanisms in place to facilitate cross-sector work by regulators?*

- *Should regulators' approach to similar issues (e.g. aspects of the price control, promoting competition and addressing consumer impacts including affordability) be more coordinated?*
- *Would shared non-executive board members across regulators helpfully reinforce collaboration, learning and coherence in approach?*

We believe there is always room for more co-operation between regulators and a more formal collaborative forum may be beneficial. We would caution against the one size fits all approach, as often different regulated entities have very different characteristics or operate in markets with very different dynamics. We are not in favour of a policy which advocates the sharing of non-executive board members. While there is nothing wrong with an individual potentially being a non-executive member of two or more regulatory authorities, it should not be mandatory as relevant industry and commercial experience is more important than having a cross-regulator view.

***Q10** How cost-effective are the regulatory frameworks overall in terms of regulatory burdens, benefits delivered and efficiency of regulatory institutions?*

We are in favour of all steps by Regulators to minimise costs. In many cases the industry itself pays for the regulator and as such we expect regulators to act prudently and efficiently, targeting resources at their priorities. It is important that regulators are adequately resourced to be able to do their job effectively, however like all other aspects of their conduct, regulators must be transparent and held to account on their spending.

**END**