TOWARDS AN IMPROVED MODEL OF ECONOMIC REGULATION IN THE UNITED KINGDOM

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ABSTRACT

This dissertation examines the means of regulating economic enterprises in the UK in the light of comparative experience. The study draws upon secondary sources in the literature both in the UK and elsewhere, and also presents empirical case-studies of its own, based on interviews with regulatory officials and agencies in the UK as well as the USA, New Zealand and Australia.

The central hypothesis of the thesis is that a legitimate regime of regulatory intervention requires mechanisms which encourage participation by interested parties, especially consumers, in conjunction with effective institutional design, so as to balance the objectives of competing interest groups. This allows economic regulation to be responsive and accountable and therefore legitimate.

The work begins with a consideration of the different approaches to the subject of regulation in the literature of law and economics. It identifies the different models of regulation adopted in other countries, especially the USA, and then proceeds to develop a range of possible “benchmarks”, or objectives of successful performance, for the evaluation of systems of economic regulation.

Succeeding chapters then examine the historical evolution of UK economic regulation and various regulatory methods involving public and private ownership structures. A model of regulatory intervention based on the central hypothesis is then developed. Detailed theoretical and empirical studies of US and UK regulatory techniques and structures follow, covering numerous contemporary issues in various sectors of economic activity. The influence of competition law, EC membership and consultation and participation initiatives is analysed, along with UK and US case studies, particularly of public utility and telecommunications regulation.

Consumer issues and the use of innovative consensual techniques are then addressed. Finally various conclusions are drawn as to the ways in which UK economic regulation needs to evolve to conform with the model of regulatory intervention developed in the thesis.
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There were times during the writing of this thesis when I felt rather like Christopher Columbus. It was said, somewhat unkindly, of Columbus that he set off not knowing where he was going, when he got there he didn't know where he was, when he got back he didn't know where he'd been, and it was all done on borrowed money. Hopefully at this stage of the endeavour, only the last feature remains true in my case!
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Save the Bay Inc v Department of Public Utilities 366 Mass 667 (1975)

10.5

Scenic Hudson Preservation Conference v FPC 354 F 2d 608 (2d Cir 1965), cert denied 384 US 941 (1966)

11.4.3

Schechter Poultry Corporation v United States of America 295 US 495 (1935)

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Science Research Council v Nasse [1979] 3 WLR 762

11.4.3

Scottish Cooperative Wholesale Society v Meyer [1959] AC 324

3.3.1


9.6.9

Secretary of State for Education and Science v Tameside MBC [1977] AC 1014

6.5.3; 8.3.6

Seven Bishops Case (1688) 12 St Tr 416

2.2.2

Shell (Petroleum Mining) Company Limited & anor v Kapuni Gas

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<td>966 F 2d 1541 (9th Cir. 1992)</td>
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<td>Taillandier-Neny [1993] ECR I-5383</td>
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November 1996)

The Great Case of Monopolies: Sandys v The East India Company (1683) 10 St Tr 371

The State of Victoria v The Master Builders' Association of Victoria [1995] 2 VR 121

Thomas v Sorrell (1674) Vaugh 330; 124 ER 1098

Trespass on the Case in Regard to Certain Mills (1444) YB 22 Hen VI, f4

Trounce and Wakefield v NCF Kaiapoi Ltd (1985) 2 NZCLC 99

Tru-Tone Ltd v Festival Records Ltd [1988] 2 NZLR 352

Trustees of the Dennis Rye Pension Fund v Sheffield City Council (Court of Appeal, 31 July 1997, LEXIS)

TV3 Network Ltd v Eveready New Zealand Ltd [1993] 3 NZLR 435

Uebergang v Australian Meat Board (1980) 145 CLR 266

Union of the Benefices of Whippingham and East Cowes, St James, Re [1954] AC 245

Unison v South West Water Services (unreported, ChD, Blackburn J, 25 August 1994)

United States v Allegheny-Ludlum Steel Corp 406 US 742 (1972)

United States v Florida East Coast Ry Co 410 US 224 (1973)

United States v Grimaud 220 US 506 (1911)

United States v Storer Broadcasting Co 351 US 192 (1956)

United States Tel. Ass'n v FCC 28 F 3d 1232 (DC Cir. 1994)

Universal Camera Corp v NLRB 340 US 474 (1951)


Waitakere City Council v Waitemata Electricity Shareholders Society Inc [1996] 2 NZLR 735

Wallersteiner v Moir [1974] 1 WLR 991

Warm Springs Dam Task Force v Gribble 621 F 2d 1017 (9th Cir. 1980)

Wayman v Southard 10 Wheat. 1 (1825)

Webster v Doe 486 US 592 (1988)

Weinberger v UOP Inc 457 A 2d 717 (1971)

Wellington Gas Company v Patten (1881) 3 NZLR 205

Wellington International Airport Ltd v Air New Zealand [1993] 1 NZLR 671

West Midlands Passenger Executive v Singh [1988] 2 All ER 873

Weyburn Broadcasting Ltd Partnership v FCC 984 F 2d 1220


Wolfe v HHS 711 F 2d 1077 (DC Cir. 1983)

Wong Yang Sung v McGrath 339 US 33 (1950)

X (minors) v Bedfordshire County Council [1995] 3 All ER 353

Zumtobel v Austria (1993) 17 ECHR 134
## SCHEDULE OF THESIS INTERVIEWS, CONTACTS AND OTHER EVENTS

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<tr>
<th>Name</th>
<th>Position</th>
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<tbody>
<tr>
<td>Adam Garfunkel</td>
<td>Friends of the Earth, London</td>
<td>27 April 1995</td>
</tr>
<tr>
<td>Charles Crothers</td>
<td>Visiting Professor of Sociology, University of Kent at Canterbury</td>
<td>16 May 1995</td>
</tr>
<tr>
<td>Bruce Carrie</td>
<td>Coopers &amp; Lybrand, Washington DC</td>
<td>7 June 1995</td>
</tr>
<tr>
<td>Bikash Mittra</td>
<td>Doctoral student, Imperial College London (researching the structure of the UK electricity industry)</td>
<td>13 October 1995</td>
</tr>
<tr>
<td>Cosmo Graham</td>
<td>Professor, University of Hull Law Faculty</td>
<td>23 October 1995</td>
</tr>
<tr>
<td>Gary J Edles</td>
<td>General Counsel, Administrative Conference of the United States</td>
<td>26 October 1995</td>
</tr>
<tr>
<td>Alan Reed</td>
<td>Lecturer in Law, Leeds University</td>
<td>27 October 1995</td>
</tr>
<tr>
<td>John Goodman</td>
<td>Partner, Freedman Church, Solicitors</td>
<td>31 October 1995</td>
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<tr>
<td>Tom Winsor</td>
<td>Regulatory Affairs Partner, Denton Hall</td>
<td>3 November 1995</td>
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<tr>
<td>Richard McGrane</td>
<td>Litigation partner, Dibb Lupton Broomhead</td>
<td>8 November 1995</td>
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<tr>
<td>Kyran Hanks</td>
<td>Economic Analyst, OFGAS</td>
<td>15 November 1995</td>
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<tr>
<td>Michael Brocklehurst</td>
<td>Chief Legal Adviser, Office of the Rail Regulator</td>
<td>17 November 1995</td>
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<tr>
<td>Peter Stanton</td>
<td>Economic Policy Analyst, Civil Aviation Authority</td>
<td>17 November 1995</td>
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<tr>
<td>Norman Lewis</td>
<td>Professor of Public Law, Sheffield University</td>
<td>20 November 1995</td>
</tr>
<tr>
<td>John Bean</td>
<td>Head of Interconnection Policy, OFTEL</td>
<td>21 November 1995</td>
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<tr>
<td>Sarah Thane</td>
<td>Director of Public Affairs, Independent Television Commission</td>
<td>22 November 1995</td>
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<tr>
<td>OFTEL hearing</td>
<td>First utility regulatory hearing held in public</td>
<td>23 November 1995</td>
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<tr>
<td>Julia Black</td>
<td>Lecturer in Law, London School of Economics &amp; Political Science</td>
<td>28 November 1995</td>
</tr>
<tr>
<td>Name</td>
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<tr>
<td>Tom Poulton</td>
<td>Partner, Arthur Robinson &amp; Hedderwicks, Solicitors, Melbourne, Australia</td>
<td>28 November 1995</td>
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<tr>
<td>Paul Chisholm</td>
<td>Chief Executive, Colt Telecommunications (Convenor of industry consultation forum)</td>
<td>5 December 1995</td>
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<tr>
<td>David Chalfen</td>
<td>Consumer Affairs Executive, OFTEL</td>
<td>6 December 1995</td>
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<tr>
<td>Linda Lennard</td>
<td>National Consumer Council</td>
<td>20 December 1995</td>
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<tr>
<td>Malcolm Grant</td>
<td>Department of Land Use Economics, Fellow of Clare College, Cambridge University</td>
<td>28 December 1995</td>
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<td>Dinah Rose</td>
<td>Barrister, 2 Hare Court, London</td>
<td>5 February 1996</td>
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<td>Paul Ryan</td>
<td>Competition Policy, OFTEL</td>
<td>12 February 1996</td>
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<td>Rosemary Hutt</td>
<td>Legal Officer, London Borough of Brent</td>
<td>11 April 1996</td>
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<td>Christalla Christodoulidou</td>
<td>Solicitor, London Borough of Haringey</td>
<td>7 June 1996</td>
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<td>Ronald St J Macdonald</td>
<td>Professor, Emeritus, Dalhousie Law School, Canada. Judge appointed to the European Court of Human Rights by the State of Liechtenstein (interviewed in Strasbourg)</td>
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<td>Anna Walker</td>
<td>Deputy Director-General of OFTEL</td>
<td>31 July 1996</td>
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<td>Christopher Guy</td>
<td>Simmons &amp; Simmons, Solicitors, London</td>
<td>21 August 1996</td>
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<td>Colin Scott</td>
<td>Lecturer, Department of Law, London School of Economics &amp; Political Science</td>
<td>21 March 1996; 18 November 1996</td>
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<td>David Russell</td>
<td>Director, Consumers Institute of New Zealand Inc</td>
<td>22 November 1996</td>
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<td>Miriam Dean</td>
<td>Barrister, Auckland, New Zealand</td>
<td>4 December 1996</td>
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<td>Michael Taggart</td>
<td>Professor, Faculty of Law, University of Auckland, New Zealand</td>
<td>5 February 1997</td>
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<tr>
<td>James Farmer QC</td>
<td>Barrister, Auckland, New Zealand</td>
<td>14 May 1997</td>
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<tr>
<td>Stephen Bailey</td>
<td>Assistant Chief Counsel, Federal Communications Commission, Washington DC</td>
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<td>Jane Assaf &amp; Steven Blow, Senior Attorneys</td>
<td>State of New York Department of Public Service, Albany, NY</td>
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<td>Mitchell Tannenbaum, Senior Staff Attorney</td>
<td>Maine Public Utilities Commission, Augusta, Maine</td>
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<td>James Connelly, Chief Counsel</td>
<td>Massachusetts Department of Public Utilities, Boston, MA</td>
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<td>George Dean, Assistant Attorney-General</td>
<td>Massachusetts Public Protection Bureau, Boston, MA</td>
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SOME USEFUL INTERNET WEB SITE ADDRESSES

Australian Government - Department of Communication and Arts

British Gas plc
http://www.bgplc.com/

BT
http://www.commstore.bt.com/

Centrica
http://www.centrica.co.uk

EC Telecommunications Policy and Materials
http://www.ispo.cec.be/infosoc/legreg/telecom.html

FCC
http://www.fcc.gov

Financial Times
http://www.ft.com

UK Government and Regulatory Press Releases
http://www.coi.gov.uk/coi/

Guardian/Observer
http://www.guardian.co.uk

IEA
http://www.iea.org.uk

IPPR
http://www.ippr.org.uk

Maine Public Utilities Commission
http://www.state.me.us/mpuc/homepage.htm

Massachusetts Department of Public Utilities
http://www.magnet.state.ma.us/dpu/

MMC
http://www.open.gov.uk/mmc/

New York Public Service Commission
http://www.dps.state.ny.us

New York State Consumer Protection Board
http://www.consumer.state.ny.us/

OFTEL
http://www.oftel.gov.uk

ORR
http://www.rail-reg.govt.uk

Railtrack plc
http://www.railtrack.co.uk

The Economist
http://www.economist.com

The Times
http://www.the-times.co.uk
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<td>Australian Competition and Consumer Commission</td>
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<td>ACUS</td>
<td>Administrative Conference of the United States</td>
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<td>ADR</td>
<td>Alternative Dispute Resolution</td>
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<td>APA</td>
<td>Administrative Procedure Act (US)</td>
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<td>BG</td>
<td>British Gas plc</td>
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<td>BT</td>
<td>British Telecom plc</td>
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<td>CAA</td>
<td>Civil Aviation Authority</td>
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<td>CCT</td>
<td>Compulsory Competitive Tendering</td>
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<td>EC</td>
<td>European Community</td>
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<td>ECCCG</td>
<td>Electricity Consumers' Committees Chairman's Group</td>
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<td>ECHR</td>
<td>European Convention for the Protection of Human Rights and Fundamental Freedoms</td>
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<td>European Court of Justice</td>
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<td>Environmental Protection Agency (US)</td>
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<td>FAA</td>
<td>Federal Aviation Administration</td>
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<td>FCC</td>
<td>Federal Communications Commission</td>
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<td>FERC</td>
<td>Federal Energy Regulatory Commission</td>
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<td>FIMBRO</td>
<td>Financial Intermediaries, Managers and Brokers Regulatory Organisation</td>
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<td>FTC</td>
<td>Federal Trade Commission</td>
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<td>GCC</td>
<td>Gas Consumers Council</td>
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<td>LAUTRO</td>
<td>Life Assurance and Unit Trust Regulatory Organisation</td>
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<td>Office of Water Services</td>
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<td>OFWAT National Customer Council</td>
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<td>Office of Passenger Rail Franchising</td>
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<td>Office of the Rail Regulator</td>
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<td>PIA</td>
<td>Personal Investment Authority</td>
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<td>Securities and Exchange Commission</td>
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<td>SRO</td>
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<td>TVA</td>
<td>Tennessee Valley Authority</td>
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1. TOWARDS AN IMPROVED MODEL OF ECONOMIC REGULATION IN THE UNITED KINGDOM - THE SCOPE OF INQUIRY

1.1 A New Approach to the Analysis of Economic Regulation

1.1.1 The Aim of the Thesis

Over the past ten years the regulation of economic activity in the United Kingdom has undergone major changes. There have been several reasons for this. First, the transition from nationalised to privatised ownership as the predominant model, with its attendant political and economic significance, has led to the growth of independent regulation in various forms. This has been particularly evident in relation to the privatised utilities and passenger rail transport. Regulatory bodies such as the Office of Telecommunications (hereafter OFTEL), the Office of Gas Supply (OFGAS), the Office of Electricity Regulation (OFFER), the Office of Water Services (OFWAT) and the Office of the Rail Regulator (ORR) are now household words and their decisions regularly achieve prominence (and sometimes notoriety) in the press. Secondly, the influence of closer EC involvement and the more recent move towards the Single Market has been reflected in the changing shape of economic regulation, especially in areas such as air transport licensing by the Civil Aviation Authority (CAA), broadcasting regulation by the Independent Television Commission (ITC) and in the structure of the electricity and telecommunications industries.

At the same time, new regulatory initiatives involving techniques such as franchising and the contracting of various public sector services are emerging, as rail privatisation and the introduction of Compulsory Competitive Tendering (CCT) bear witness. Other industries, such as local bus transport and long distance express coaching, have been largely deregulated. Significant areas of self-regulatory activity have also emerged, particularly in relation to the financial services sector and the press. The UK economy is therefore now regulated by a variety of techniques, which will be discussed in more detail later in this chapter and subsequently.

These changes in the shape of UK economic activity have been accompanied by significant developments at the level of legal theory and in its expression through
legislation. Public and administrative law in the United Kingdom has undergone many recent changes, in part at least in response to some of the above economic and political developments. Administrative law has had to grapple with the challenges posed by the new regulatory bodies in areas such as the procedural requirements for decision making and the amenability of such bodies to judicial review. Emerging doctrinal areas such as legitimate expectations and procedural and substantive requirements derived from concepts of fundamental rights are also of increasing relevance to the regulatory area.

In the field of commercial law, developments in competition and trade practices law have also been of great significance in relation to the new regulatory structures.

This thesis seeks to provide new insights into these regulatory developments in the United Kingdom by focusing on five aspects. These are:

• the justifications for economic regulation;
• the objectives sought to be achieved by the regulation of economic activity;
• the benchmarks by which the performance of regulatory regimes should be assessed;
• the effectiveness of differing techniques of economic regulation in terms of these considerations;
• the defining of a new model of regulatory intervention which embodies the above features and which emphasises the central importance of consultation and participation in implementing any system of economic regulation.

Much contemporary scholarship and academic enquiry in this area has been concerned with analysing techniques of regulatory intervention from a constitutional, institutional or bureaucratic perspective. Often such analysis does not clearly articulate the goals to which an ideal system of economic regulation should aspire or the processes which are available for the achievement of such goals. This thesis seeks to overcome such deficiencies of approach in the current academic treatment of the subject. It approaches this task by subjecting a range of contemporary UK regulatory techniques to rigorous theoretical, comparative and empirical analysis. The theoretical analysis
considers the objectives to be achieved by a regulatory regime in the economic sphere and the methods available for their attainment. At the comparative level, regulatory developments in the United States and in Commonwealth jurisdictions and their possible application in Britain will be considered. The empirical analysis is based on extensive field work, involving interviews with a number of regulatory officials and other affected parties together with some detailed practical evaluation of the workings of various regulatory bodies, both in the United Kingdom and the United States.

The perspective adopted is a multi-disciplinary one which draws widely on the relevant academic literature in economics, political science and sociology, combined with some historical and philosophical material. While the thesis places primary emphasis on the role of legal doctrine and of public and administrative law in particular in bringing about an improved system of economic regulation, the influence of economic and political factors is also given due recognition. These range from theories of public versus private ownership to the influence of EC developments on the design of regulatory structures and processes.

At a more general level the thesis seeks to identify the essential attributes of a public interest based theory of regulation in terms of contemporary experience in the United Kingdom. It examines the ways in which the interests of differing participants in the regulatory process can be balanced or reconciled and the manner in which the design of processes and institutions can help to achieve desired regulatory outcomes. In terms of its overall approach, the thesis inclines heavily to the view that the concepts of effective economic regulation and genuine participatory democracy are closely interlinked. As the regulatory benchmarks to be discussed later in this chapter indicate, considerable emphasis is placed on the need for transparent and accountable procedures which facilitate effective participation in the regulatory process by interested parties in a structured way and require meaningful consultation with those parties. Much of the analysis in the succeeding chapters will be directed to identifying those legal mechanisms which serve to encourage such consultation and participation and also those which do not. Exploring ways of encouraging the former and reducing the influence of the latter represents a large part of the task at hand.
1.1.2 The Scope of Inquiry

Regulation is a concept with a central core of meaning surrounded by a more vaguely defined outer penumbra. Before proceeding further, it is desirable to clarify the scope of inquiry. In their broadest sense, terms such as regulation and the regulatory process can encompass state involvement in regulating all forms of economic and social behaviour, including the use of criminal and quasi-criminal sanctions. When reference is made to government regulation, both colloquially and in academic writing, the intention is often to include a wide range of statutory and other forms of legislative provision. These might consist of delegated legislation, local authority by-laws and the various kinds of quasi-legislative rules which are to be found in the modern state.¹

It is now quite unexceptional to find governments seeking to regulate a wide range of economic and social activities in areas as diverse as the content of advertising and television programmes, product safety regimes, building codes, parking arrangements for motor vehicles, licensing of homeopathic remedies and controls over the availability of pharmaceutical substances.² This breadth of involvement is reflected in the huge volume of both primary and secondary legislation being passed by legislatures in jurisdictions such as the United Kingdom and the United States. It is also reflected in phrases such as "rules and regulations", and less flatteringly in references to bureaucracy and "red tape". The broad scope of regulatory activity has

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1. Several authors, such as Professor Ogus in his recent book, Regulation: Legal Form and Economic Theory (Clarendon Press, Oxford, 1994), at pp 1-2, refer to this diversity of meaning. Ogus observes at p 1: "It [the expression 'regulation'] is not a term of art, and unfortunately it has acquired a bewildering variety of meanings. Sometimes it is used to indicate any form of behavioural control, whatever the origin." See also the range of topics addressed in Bishop, Kay and Mayer, The Regulatory Challenge (OUP, Oxford, 1995), in which the contributors cover not only utilities, broadcasting and the National Health Service, but also the provision of legal services, the efficiency and quality of higher education, regulation of product quality and the provision of consumer information. For a discussion of the wide range of meanings of the term "regulation" in the United States context see Mitnick, The Political Economy of Regulation (Columbia UP, New York, 1980), chapter 1.

also given rise to the need for a multi-disciplinary approach to issues of regulatory analysis and has made the academic boundaries of the topic difficult to define with any clarity.³

Our concern in the present context is a somewhat narrower one. The type of regulation in contemplation in this thesis is the control exercised by government over economic activity through some external means. The characteristics of this form of regulation are that it is systematic, generally of a long term nature and has a public interest element. The state exercises its regulatory role either through a public agency of some kind (but sometimes also by the use of contractual mechanisms), or through an organisation created by legislation and charged with upholding industry standards in the public interest.⁴ The latter alternative is often represented by various types of self-regulation.⁵

This perceived need to exercise control over economic activity by externally imposed mechanisms is a characteristic of most modern market-based economies.⁶ Modes of

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3. See for example Majone, "Introduction" in Majone (ed), Deregulation or Re-regulation? Regulatory Reform in Europe and the United States (Pinter Publishers, London, 1990) at p 1: "There are several reasons why European social scientists have not developed anything comparable to the American theories of regulation. To begin with, the term itself is often used differently on the two sides of the Atlantic. In Europe there is a tendency to identify regulation with the whole realm of legislation, government and social controls. This broad use of the term makes the study of regulation coextensive with law, economics, political science and sociology, and thus impedes the development of a theory of regulation as a distinct kind of policy-making."


5. Some economic commentators on the regulatory scene, such as Swann, note that it may be difficult to distinguish definitively between systems of external government regulation and self regulatory regimes. See Swann, "The Regulatory Scene: An Overview" in Button and Swann (eds), The Age of Regulatory Reform (Clarendon Press, Oxford, 1989) at p 4: "In practice it is not always easy to draw a hard and fast line between these two systems. Although it is possible to identify situations where there is no external authority, in many cases what we encounter is a mixture of the two. In the professions, for example, standards of competence and conduct are often governed by institutions which, while they owe their existence to the state, are then left very much to themselves to devise and implement standards. A somewhat similar case arises in the UK under the Fair Trading Act 1973, whereby codes of conduct are drawn up by firms in particular trades."

6. Both the economies of Germany and Japan exhibit significant government intervention at various levels, but are not commonly thought of as being collectivist, rather than market-based, in nature by reason of such activity. See Grant, The Political Economy of Industrial
control exhibit great variety, and include methods that rely for their enforcement authority on both the civil law and the criminal law. The use of criminal law techniques gives rise to a number of interesting issues that have been addressed in detail by others and are in any event somewhat beyond the ambit of the present study.¹ In the present context we shall be primarily concerned with analysing methods of externally imposed government regulation in UK economic affairs.

1.2 The Structure of the Thesis

A brief outline of the structure of the thesis will serve to illustrate the approach to be taken. Chapter 1 is an introductory chapter which describes the scope of the concept of economic regulation and the justifications for regulatory intervention. It identifies the features that should be present in an ideal regulatory regime and describes how the approach to regulation taken in this thesis represents an original contribution to the academic treatment of this area. The research methodology is described, including the approaches taken in the existing literature, and the theoretical, comparative and empirical studies undertaken here. The chapter also discusses the economic and political factors influencing the regulatory process and the relationship between economic regulation and administrative law concepts.

In chapter 2 the evolution of regulatory regimes in the United Kingdom is considered from an historical perspective, with a view to demonstrating the extent to which some of the requisite elements of an ideal regulatory regime have been realised in the past and also to illustrating some of the difficulties and deficiencies of regulatory

¹ See for example Ball and Friedman, "The Use of Criminal Sanctions in the Enforcement of Economic Legislation: A Sociological View" (1965) 17 Stan LR 197; Rowan-Robinson, Watchman and Barber, Crime and Regulation: A Study of the Enforcement of Regulatory Codes (T & T Clark, Edinburgh, 1990); Ogus, supra note 1, chapter 5.
methods adopted in previous eras. This survey will cover early attempts at economic regulation in Britain from the Tudor and Stuart periods onwards, through to attempts to regulate monopoly power in the succeeding centuries. It includes discussion of the development by the common law of the concept of public utility services and the attendant obligations of their providers to take into account the public interest and to provide a universal service. The role of commission structures in implementing economic and social regulation in Victorian times will then be considered, leading on to the use of nationalised ownership in the present century as a method of imposing direct government control of industry. Finally the era of widespread privatisation of industry during the 1980s will be considered. The emphasis in the course of this analysis will be on learning from the lessons of the past and applying this knowledge to the design of an improved regime of economic regulation which incorporates the benchmark features which are discussed later in that chapter.

Chapter 3 examines public ownership as a technique of economic regulation. This chapter begins by analysing public ownership as a means of regulatory control. It then looks at issues of corporate structure, such as the use of government shareholdings, nominee and independent directors and the shortcomings of these various techniques. The chapter also considers whether a more enlightened form of company law could encourage the use of public ownership as a relatively flexible technique of economic regulation.

Chapter 4 consists of an examination of other methods of economic regulation, including the use of commission and agency structures, franchising, contracting out of services, taxes, subsidies and incentives, consensual processes such as negotiation and bargaining, and industry self-regulation. These varying techniques are evaluated in terms of the regulatory benchmarks set out in chapter 1. The interplay between rules and discretion in the design of regulatory techniques is also considered. This chapter lays the groundwork for the development of a new model of economic regulation in chapter 5.

The features of such a model are described in chapter 5. This model is based on the central concept that the only legitimate form of externally imposed economic regulation in a democratic system is one which allows for competing interests in the
regulatory system to be assessed and balanced following full consultation and participation by all interested parties. The features of this model form the underlying basis for analysis in the succeeding chapters.

Chapter 6 consists of a detailed examination of economic regulation in the United States as the basis for a comparative study of the possible application of US regulatory techniques in the UK. The background to, and rationale for, US economic regulation will be considered in the context of the development of the independent regulatory agencies, beginning with the Interstate Commerce Commission in 1887. Theories seeking to explain the nature and behaviour of the regulatory agencies in the United States, such as capture theory and various forms of principal and agent based theory, will be discussed. US regulatory techniques, such as rule making and adjudication under the Administrative Procedure Act 1946, will be considered in detail, together with the scope of judicial review of regulatory decisions. Various difficulties with contemporary rule making activity will also be addressed. More recent developments, such as negotiated rule making and the use of consensual procedures in the adjudication context, will also be considered.

The thesis returns to the subject of UK economic regulation in chapter 7. This chapter applies some of the theoretical concepts discussed in chapter 4 to selected areas of contemporary economic regulation in Britain. It summarises the present state of regulatory activity in areas such as the privatised utilities, rail and air transport, television licensing and financial services, and incorporates an examination of the goals of economic regulation in each area, the applicable legislative framework and the regulatory techniques which are employed.

Areas covered include the extent of existing rule making activity, the use of consultative procedures and public hearings, the availability of MMC review, and the existence of self-regulatory approaches. Some areas of the UK economy, such as local bus transport and express coaching, are largely unregulated at present and chapter 7 also looks at the implications of this. In addition the chapter discusses the possible application of US theories as to the nature of the regulatory process discussed in chapter 6, including capture and principal/agent theories. A significant
part of the chapter examines the increasing influence of EC law and practice on UK economic regulation.

Chapter 8 is concerned with the possible application of formalised consultation and participation techniques to the UK regulatory scene. This chapter begins by looking at the existing use of consultative procedures in the UK, in the light of both historical experience and the evolving doctrine of legitimate expectation, and also considers the general issue of parliamentary control over delegated legislation of various kinds. Legislative regimes in force in Victoria, Australia and in Quebec, Canada are considered. It moves on to discuss the desirability of a modified APA-type procedure in Britain and considers what would be involved in introducing such a system.

This exercise involves some consideration of the extent to which the common law already recognises or requires participation requirements in relation to the regulatory process, including some discussion of the role of concepts of fundamental rights in this area, with particular reference to current developments under the European Convention on Human Rights and the Canadian Charter of Rights and Freedoms. The need for an enabling statute and modified judicial review techniques will also be considered.

Case studies of contemporary UK economic regulation are dealt with in chapter 9, which begins by looking at recent experience with the existing use of consultation and participation regimes in various areas of UK economic regulation. Consensual procedures adopted by the Rail Regulator and OFTEL, ITC consultation procedures and the role of CAA public hearings in civil aviation regulation are also examined. Finally the chapter looks in detail at the new OFTEL licence condition dealing with anti-competitive behaviour in the UK telecommunications industry. The object of these case studies is to assess the extent to which existing UK regulatory procedures reflect the characteristics of an ideal regulatory regime, as described in this opening chapter, and to identify areas in which further improvements in the existing regulatory regimes can be made.

A similar exercise is undertaken in chapter 10, which consists of case studies of US economic regulation, building on the theoretical analysis of US economic regulation
in chapter 6. This chapter looks in particular at the implications of the division of regulatory responsibility in a federal system, the regulatory activities of several state public utility commissions and consumer protection boards, with particular reference to the work of these bodies in the states of New York, Maine and Massachusetts, and the contemporary use of rule making procedures in a federal regulatory agency, the Federal Communications Commission (FCC). These case studies seek to illustrate the current state of rule making and public hearing procedures in the United States, including the increased use of negotiated settlements and similar consensual techniques, the role of judicial review, the extent of judicial deference accorded to regulatory decisions, and the ways in which the consumer interest is represented.

Consumer and enforcement issues arising in the context of economic regulation are discussed in chapter 11. This chapter considers the extent to which economic regulation should reflect the interests of consumers, particularly in relation to other stakeholder groups in the regulatory process, such as shareholders and the regulated firms themselves. It looks at ways of encouraging consumer involvement in regulatory decisions, areas in which the consumer interest is particularly significant and the possibilities for bringing private enforcement actions in the regulatory context.

The role of organised interest groups in this area is also examined and comparisons are made between the UK system and the way in which the consumer interest is represented under the US regulatory system, drawing on the US case studies in chapter 10. The role of formal intervention in the regulatory process and the ways in which representation of the consumer interest in Britain could be enhanced, particularly through the adoption of APA-type procedures, are also discussed.

Chapter 11 also includes an examination of the possible use of innovative regulatory methods in the context of UK economic regulation. The adoption of consensual procedures, such as arbitration, mediation and ADR processes, is considered. The chapter seeks to identify the conditions which favour the adoption of consensual regulatory procedures and the advantages which would be likely to flow from their use. The emphasis is on demonstrating how the use of such processes is likely to
assist in achieving the goals of an improved regulatory regime, while promoting the interests of third parties such as consumers.

Finally, chapter 12 contains a summary and conclusions and seeks to show how the matters discussed in the preceding eleven chapters go to promote the thesis argument expounded in chapter 1. The final chapter also deals with the processes which are best suited to realising the objective of better regulation and the steps needed to achieve these goals in the context of UK economic regulation.

1.3 Areas in Which the Thesis Makes an Original Contribution

The discussion in this chapter and in the next chapter will serve to illustrate that much of the existing economic regulation in Britain arose on a comparatively ad hoc basis as a consequence of the privatisation movement of the 1980s, although externally imposed regulation of this kind has been an established feature of the US scene for more than a century. Existing studies of UK regulation in this area have generally approached the subject from a constitutional, institutional or descriptive perspective. Little if any detailed analysis has so far been carried out on the relationship between issues of regulatory design and the attainment of desirable regulatory objectives.

The present thesis seeks to remedy this omission in the existing scholarship by showing how considerations of regulatory design and approach can lead to improved regulatory outcomes. In pursuing this theme, the thesis includes a strong comparative element, dealing in some detail with the possible application of US regulatory techniques in Britain.

modified US APA-type procedures in the UK and the benefits which could result from such a course. The thesis also contains the first detailed UK study of the extent to which such procedures could be introduced by way of judicial initiatives, perhaps by invoking concepts of fundamental rights or by further development of the doctrine of legitimate expectation, and the issue of whether the regulators themselves could choose to adopt such procedures in the absence of a general empowering statute.

In addition the thesis draws on Commonwealth experience with various regulatory techniques, particularly from Canada, Australia and New Zealand. These studies of Commonwealth regulatory methods include the rule making powers of regulatory bodies in Canada and Australia, and the novel use of arbitration and mediation techniques for the resolution of utility interconnection disputes in New Zealand. Little, if any, comparative academic work has been carried out in these areas to date.

The thesis also incorporates a good deal of empirical research, including an in-depth look at some operational aspects of regulatory agencies in both the UK and the US, based on a number of interviews with regulatory officials and other field work carried out in both jurisdictions. Details of the agencies which have been the subject of this research and the interviews conducted are contained in the Schedules in the Table of Contents. The activities of the major economic regulators in Britain will be described in some detail in the course of the succeeding chapters.

This empirical research into UK regulatory bodies raises several issues which have also been largely unexplored to date. These include the existing and potential use of consensual and innovative techniques in UK regulation, the development of structured industry consultation and participation procedures and the use of discretionary regulatory powers to counter the problem of anti-competitive market behaviour. These aspects are illustrated by reference to the activities of the regulators of the privatised utilities and of rail and air transport and the role of the ITC in relation to television broadcasting and licensing.

Another significant part of the research methodology employed consists of some empirical studies of US regulatory bodies, including several US state public utility commissions and consumer protection agencies, and a study of some of the regulatory activities of a federal regulatory agency, the Federal Communications
Commission (FCC). These case studies of both UK and US economic regulation reflect current practice in both jurisdictions. This has changed considerably, and in many cases unrecognisably, over the past few years.

This is particularly so with US regulation, where the use of fully-fledged adversarial techniques and public hearing procedures is declining in significance in areas such as rate-setting, and consensual procedures and negotiated settlements are assuming increasing importance. The US studies are also important in illustrating how structured methods of representation can promote the consumer interest in regulatory matters, an area which is of much contemporary relevance to the UK situation.

The thesis also seeks to lay a detailed basis for a new model of economic regulation based on the need to balance the interests of competing groups in the regulatory process. It defines the interests involved and shows how innovations in public and administrative law and in regulatory procedure can assist in reconciling them.

In summary, the thesis breaks new ground in its detailed study of theoretical, comparative and empirical aspects of the topic and in the accompanying analysis of the results of this research.

1.4 Research Methodology

1.4.1 The Approaches Taken in the Literature to Date

(i) Introduction

This part of the chapter summarises the approaches taken in the literature to date to the topic of economic regulation from a legal, economic and political science perspective, with a view to identifying how the perspective adopted in this thesis differs from existing studies of the subject. Research for this thesis has involved reference to more than 300 books and monographs and several thousand periodical articles, legislative enactments, reported cases, official publications and other primary and secondary sources. Details of the more relevant items from among this plethora of material are listed in the bibliography that follows the final chapter. Not all of the secondary material will be referred to here but this part of the chapter will
mention some of the literature which bears more or less directly on the areas covered in this thesis.

(ii) UK Legal Texts

To begin with legal texts, the subject of regulation in the United Kingdom has received some attention from legal commentators in recent years. The standard UK administrative and public law texts generally include one or more chapters on the subject of economic and social regulation, which often focus on areas such as consultation procedures, the accountability of the regulators and the applicable legislative framework.9

Texts which deal more generally with the constitutional status of governmental and quasi-governmental agencies and with matters of general constitutional principle in this area also provide useful background.10 More specialised texts dealing with particular areas of administrative law such as judicial review,11 delegated

9. Perhaps the best overall treatment of the subject in the general texts is found in Craig, Administrative Law (Sweet & Maxwell, London, 3rd ed, 1994), who devotes part of several chapters, particularly 3, 6, 7 and 11, to the processes of government, rule making and discretion, with particular reference to the UK regulatory process and also draws some limited comparisons with US practice. Other general texts such as Foulkes, Administrative Law (Butterworths, London, 7th ed, 1990) and Wade and Forsyth, Administrative Law (OUP, Oxford, 7th ed, 1994) focus more on administrative tribunals generally and tend to deal with economic regulation only in passing. McEldowney, Public Law (Sweet & Maxwell, London, 1994) has a useful chapter on nationalisation, privatisation and the regulation of the privatised industries. Thompson, Textbook on Constitutional and Administrative Law (Blackstone Press Limited, London, 1993) also contains a brief treatment of these areas.


11. The most comprehensive and certainly the most up to date general text on judicial review in the United Kingdom is de Smith, Woolf and Jowell, Judicial Review of Administrative Action
legislation,\textsuperscript{12} access to official information and the problem of government secrecy,\textsuperscript{13} and administrative procedures generally,\textsuperscript{14} have been essential sources of reference.

In terms of legal approaches to the regulatory process itself there have been several publications which are worthy of note here. These include a pioneering study by Professors Graham and Prosser, published in 1991, of constitutional aspects of the privatisation process, which contains a chapter on regulatory procedures, and also makes some reference to the United States regulatory position and to US techniques such as negotiated rule making.\textsuperscript{15} Baldwin and McCrudden have edited a book, published in 1987, which includes some interesting case studies of UK social and


\textsuperscript{15} See Graham and Prosser, \textit{Privatizing Public Enterprises}, supra note 8, and chapter 7 in particular.
economic regulation and regulatory bodies but which predated more recent developments in the area.16

Baldwin has written more recently on the subject of government rule making and regulatory compliance, with particular reference to the field of occupational health and safety and to EU influences on the rule making process, and Black has done the same in relation to the UK financial services sector.17 This book draws some interesting comparisons with US practice in this area and will be referred to in later chapters. It also contains a useful analysis of the relationship between rules and discretion, an issue which will arise later in this thesis and which has been the subject of more specialised work by other writers.18 Other work along similar lines in relation to issues of regulatory compliance, particularly in the environmental protection area, has also been produced.19

A more general treatment of the regulatory process has recently been undertaken by Professor Ogus, who has dealt with areas of both economic and social regulation and has related developments in this area to the underlying political and economic theories.20 It includes some thoughtful material on the use of criminal sanctions and on regulatory techniques such as public ownership and franchising. This book provides a useful survey of theories of regulation but does not deal in any depth with


20. Ogus, supra note 1.
US or Commonwealth experience of differing regulatory approaches. Indeed it expresses some degree of scepticism as to the efficacy of the US regulatory process, but without providing much accompanying analysis of the US system to support this view.\textsuperscript{21}

In the general competition law area, which is relevant to regulatory issues in the economic sphere, there have been some recent texts which address points of interest, particularly in relation to aspects such as interconnection arrangements, the role of the MMC and problems arising from the abuse of a dominant market position.\textsuperscript{22}

The position of consumers under UK law has also been the subject of several texts.\textsuperscript{23} In addition, there are more specialised publications which cover particular industries from a legal perspective, including the former nationalised industries,\textsuperscript{24} the electricity industry,\textsuperscript{25} the water industry,\textsuperscript{26} civil aviation\textsuperscript{27} and television broadcasting.\textsuperscript{28} To

\begin{itemize}
\item \textsuperscript{21} See for example the excerpt referred to in note 142, \textit{infra}. For a similarly ambivalent view of the application of US public law concepts to the UK scene see Loveland (ed), \textit{A Special Relationship? American Influences on Public Law in the UK} (Clarendon Press, Oxford, 1995), especially chapter 1 by Loveland entitled, "Introduction: Should We Take Lessons from America?" At p 5 Loveland observes: "The attitude taken in this volume towards 'Americanization' as a subcurrent within the (to misquote Lord Denning) incoming internationalist tide is perhaps best characterized as 'open-minded scepticism'."
\item \textsuperscript{24} Prosser, \textit{Nationalized Industries and Public Control} (Clarendon Press, Oxford, 1986).
\item \textsuperscript{26} Macrory, \textit{The Water Act 1989} (Sweet & Maxwell, London, 1989), which is largely a reproduction of the relevant legislation in annotated form.
\item \textsuperscript{27} Baldwin, \textit{Regulating the Airlines} (Clarendon Press, Oxford, 1985), although the CAA regulatory regime has undergone significant changes since this book was published, as will be described in chapter 7; Blackshaw, \textit{Aviation Law & Regulation} (Pitman Publishing, London, 1992).
\end{itemize}
date there have been few if any UK legal texts dealing specifically with the contemporary energy sector as a whole, or with the gas industry, rail transport, and telecommunications.29

Later chapters of this thesis discuss the possible adoption in the UK of consensual regulatory techniques, perhaps involving the use of mediation and ADR type techniques. In the course of this exercise some of the literature in this evolving area will be referred to, of which there are some UK examples.30

Finally in relation to legal aspects of economic regulation in Britain, some mention should be made of the numerous individual monographs published by various institutions and interest groups in this area.31 These are of variable quality, some being excellent and perceptive surveys, and others giving the impression that they were concocted in haste the morning before being presented at a conference. Some have obviously been tailored for a particular political or economic audience and many of them toe a discernible party line in rather obvious ways. Particular examples have clearly been commissioned specifically to promote a particular political or economic perspective. Nevertheless, subject to these reservations, these can often be a fruitful source of information, statistics and detail on current regulatory policies and practices, and a number of these publications are referred to in the notes to the various chapters.


31. There seem to be at least 20 such organisations publishing relevant material in the UK, some of the more prominent examples being the Centre for the Study of the Regulated Industries, the Regulatory Policy Institute, the Institute of Economic Affairs, the Institute for Public Policy Research, the Public Finance Foundation, the Adam Smith Institute, the Fabian Society, the European Policy Forum, Oxford Economic Research Associates and the Centre for Policy Studies. Various publications of these bodies will be cited in the course of the thesis.
In summary, while there are perhaps three or four UK legal texts which touch on the thesis topic, these either address only particular aspects of the issues with which the thesis is concerned or else have been overtaken, or are facing being overtaken, by the rapid pace of change in this area. Just in the past three years, for example, there have been a number of far-reaching changes in UK economic regulation. The privatised utility regulators have developed new consultation and decision-making procedures, the prospect of imminent, unrestricted competition in these industries is transforming the regulatory scene, the focus of regulatory enforcement in telecommunications has recently shifted to the control of anti-competitive market practices, and consensual regulatory procedures are a feature of areas such as rail regulation.

In particular areas of the UK economy great changes are also occurring which have had a significant impact on the regulatory process. In the period since 1992, technological innovations in the telecommunications industry have raised new regulatory issues, the Third Package of EU regulations has had a direct effect in the area of civil aviation regulation and an ambitious programme of rail privatisation is well under way. New television licences have been allocated (and the relevant ITC decisions have been challenged by judicial review), the deregulation of the local bus industry has posed its own particular problems and previously monolithic entities such as British Gas are being restructured into smaller units.

No doubt in another five years the shape of the UK economy and of UK economic regulation will look quite different again. This is especially the case given the move towards full competition in electricity, gas and telecommunications, the influence of EC developments and the possibility of the recent change of government influencing the shape of regulatory policies, particularly in relation to the utilities and rail privatisation.

These developments do of course provide particular challenges and opportunities for legal scholars, as well as threatening existing legal scholarship with a faster than usual rate of obsolescence. Hopefully this present work may serve to highlight the benefits of applying considerations of regulatory design to the task of improving the implementation of economic regulation. Such an approach is also likely to stand the test of time rather better than alternative perspectives on the regulatory process.
(iii) Commonwealth Legal Scholarship in this Area

There is a comparative dearth of legal scholarship in the area of law and economic regulation in Commonwealth jurisdictions. Some of the leading administrative law texts in Canada, Australia and New Zealand touch on aspects of the regulatory process and will be mentioned in the course of this thesis. Reference will also be made to some more specialised administrative law texts in areas such as the use of delegated legislation in Commonwealth jurisdictions and the influence of official information legislation.

Texts in the area of competition law and in relation to particular regulated industries also provide useful background but little has so far been written on the general legal aspects of economic regulation in individual Commonwealth jurisdictions. Some of the reports of Commonwealth statutory law reform agencies


and government bodies are of more direct relevance and several of these will be referred to in the course of this thesis.37

(iv) US Legal Scholarship in the Area of Economic Regulation

The US independent regulatory agencies play a central role in US administrative law in a way that has not been matched in other jurisdictions. For this reason, and also because of the central constitutional and economic significance of the regulatory agencies, a vast amount of US legal scholarship, consisting both of books and periodical articles, has been generated in this area.38

These publications range from standard texts on administrative law39 and law and regulation,40 to more specialised works dealing with the constitutional position of the regulatory agencies,41 their legislative history and evolution,42 expertise,43 rule


38. In the course of researching this thesis the writer has noted over 200 US texts on legal and economic aspects of the regulatory process. There are at least as many US periodical articles on the subject as well.


making and adjudicative functions, \(^{44}\) discretionary powers, \(^{45}\) judicial supervision \(^{46}\)
and studies of the wider legal, economic and political context within which the agencies operate. \(^{47}\)

In addition US texts on law and economics have also made a contribution in this area, particularly in identifying economic factors that influence the design of regulatory rules. \(^{48}\) Very little comparative work in the US on the application of

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regulatory techniques from other jurisdictions has been carried out. Indeed much of the comparative work on UK and US administrative law is now becoming somewhat dated. The publications of the now defunct Administrative Conference of the United States on the US administrative and regulatory process should also be mentioned at this point and reference will be made to these materials in the course of this thesis. Considerable recent work has also been carried out in the US on the use of consensual techniques in resolving public policy disputes and several texts have been published in this area. The possible application of these techniques to the process of economic regulation will be considered in more detail in chapter 11 of the thesis.

(v) Texts Written From an Economics Perspective

There are a number of texts which are of relevance in this area. In the UK, economic aspects of the privatisation process have been dealt with in some detail, as have issues in economic regulation itself, including the effect of regulation on economic performance, investment and market entry, the control of natural monopoly and

49. One example is the comparative study by Schwartz and Wade referred to above, supra note 11.

50. A full set of Administrative Conference publications was kindly supplied to me by Mr Gary Edles, formerly ACUS general counsel and now a law teacher in Washington DC. Reference will be made to several of these publications in chapter 6.


specific regulatory aspects such as the design of price capping formulas, consumer protection issues and institutional structures. Sir Christopher Foster's book on natural monopoly regulation has also proved to be a useful source of ideas, although its author may well not agree with a number of the views expressed in this thesis!

The historical basis of utility regulation has been explored in some of the older works on public utilities and the economic performance of the former nationalised industries has also received detailed scrutiny. Some of the privatised utilities have also been the subject of individual study from an economics perspective. In recent times much of this analysis has been contained in individual chapters in collections of essays, rather than in separate texts on each sector. Again, a number of

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58. Foster, *Privatization, Public Ownership and the Regulation of Natural Monopoly* (Blackwell, Oxford, 1992). While this writer would agree with Foster on some of the basic prerequisites for an effective regulatory regime (see the excerpts from Foster's book quoted in notes 139-141, 143-145 below) our respective views on the relative weight to be placed on certain factors (particularly those of accessibility, fairness and enforceability) and the means of achieving them, would be likely to differ.


61. See chapters in Bishop, Kay and Mayer (eds), *supra* note 52.
monographs and published papers have been invaluable in discussing the economic aspects of particular areas, including the privatised utilities, rail and air transport and television regulation. Many of these contributions will be referred to in the course of the various chapters.

The UK economic literature, with one or two exceptions, tends not to address issues of process or the design of regulatory institutions. It is often characterised by a suspicion of procedures which have the appearance of requiring additional participation, which seem to involve excessive reliance on concepts of 'due process', or which might be regarded as 'legalistic' in nature.

These sentiments are often translated in their entirety into wholesale dismissal of the US regulatory system, an approach which will be seen to be quite unjustified when the US system, as it now functions in practice, is examined in more detail. This thesis will advance the view that US procedures along APA-type lines do not necessarily represent a great departure from current UK practice in any event and that remaining areas of difficulty can be tackled by relatively straightforward modifications to the US approach.

Some mention should also be made of the work of Commonwealth economists in this area. Privatisation and the consequent need for economic regulation have not featured as prominently in Canada and Australia until more recently and the relevant economic literature from these jurisdictions is comparatively sparse, at least in terms of published texts. New Zealand embarked on a more radical programme of economic restructuring during the 1980s involving a considerable degree of

62. Two such exceptions are Foster, supra note 58; Helm (ed), supra note 57.

63. See for example, Foster, supra note 58, pp 414-417; Ogus, supra note 1 in the passage cited in note 142, infra.

privatisation activity and there is some economic literature available on the New Zealand experience in this area.65

There are a vast number of US texts on the economic regulation of industry. This is no doubt unsurprising given the length of US experience in this area, with the pioneering regulatory body, the Interstate Commerce Commission, having been established over a century ago.66 This literature covers all aspects of the topic, ranging from the theory of natural monopoly regulation67 to the economic effects of industry regulation,68 strategic use of the regulatory process,69 issues of regulatory


reform and the deregulation movement,\textsuperscript{70} and the application of public choice and free market theories.\textsuperscript{71}

There are also numerous more specialised publications by American economists, dealing with areas such as public utility regulation and the economic role of the state public utility commissions,\textsuperscript{72} together with the regulation and deregulation of specific industries such as electricity,\textsuperscript{73} telecommunications\textsuperscript{74} and broadcasting and television.\textsuperscript{75} More colourful contributions by consumer advocates such as the well

\begin{itemize}


\item \textsuperscript{75} Krasnow, Longley and Terry, \textit{The Politics of Broadcast Regulation} (St Martin's Press, New York, 1982); Kuhn, \textit{The Politics of Broadcasting} (Croom Helm, Beckenham, 1985); Tunstall, \textit{Communications Deregulation: The Unleashing of America's Communications Industry} (Basil Blackwell, Oxford and New York, 1986).
\end{itemize}
known Ralph Nader\textsuperscript{76} and by investigative journalists such as Kohlmeier\textsuperscript{77} can also be found.

Many of these texts deal with the economic structure of particular industries and with the deregulation initiatives of the 1980s. Few of them focus on issues of process and, so far as my reading has ascertained, none of them deal with the possible application of US regulatory techniques in Britain.

(vi) Texts from the Perspective of the Political and Social Sciences

There are several UK texts in the area of economic and social regulation which are written from a political science or social science perspective.\textsuperscript{78} These contributions generally approach the topic from the perspective of the political and democratic foundations of the regulatory process, whereas this thesis is primarily concerned with the application of legal processes and with ways of improving techniques of economic regulation.

There have also been some interesting UK political and social science contributions in recent years in areas such as the activities and organisation of interest groups, pressure groups and similar associations.\textsuperscript{79} Some of this work harks back to earlier theories of corporatism in the UK but the temptation to delve into this area has been resisted. This is partly because such a foray is outside the scope of the present work and partly also because the relative decline of the nationalised industries and of tripartite bargaining structures during the 1980s appears to have reduced the


explanatory power of such theories in relation to the current political and economic structure of Britain.\textsuperscript{80} In addition there are the more standard works on British politics and the structure of government.\textsuperscript{81}

The political background to UK nationalisation has been covered by writers such as Morrison, the original architect of the public corporations\textsuperscript{82} and more recently by others.\textsuperscript{83} Some work has also been done on the political considerations affecting the structure of regulatory institutions in the financial services sector.\textsuperscript{84} More recent innovations such as public choice theory and its applications have also been the subject of several texts.\textsuperscript{85}

Little empirical work from a political or social science perspective has been carried out on the institutions of UK economic regulation. However, some interesting studies have been done on aspects of social regulation, particularly law enforcement activities\textsuperscript{86} and environmental regulation.\textsuperscript{87}

\textsuperscript{80} For examples of some of the literature on corporatism in the United Kingdom see Middlemas, 


\textsuperscript{86} Hutter, *supra* note 19.
Reference will also be made from time to time in the course of the thesis to the defining work of the German sociologist Max Weber on the nature and behaviour of bureaucracies and their relationship to economic and political theory. Much of this work is useful by way of background only in the context of the present enquiry. However it does serve to inform the debate about which types of regulatory structure are best equipped to implement the improved regulatory techniques to be developed in this thesis.

So far as Commonwealth material is concerned, not a great deal has been undertaken in relation to the analysis of economic regulation from a political or social science perspective. One notable exception is a useful study in the 1980s of the enforcement strategies of Australian business regulatory agencies by Grabosky and Braithwaite. In contrast with the UK, US academic writers in the political and social science areas have devoted a good deal of attention, much of it unflattering, to the US regulatory agencies. Pioneering work on a theoretical model of agency behaviour was undertaken by Bernstein, whose famous 'life cycle' theory will be explored in more detail in chapter 6. The phenomenon of agency capture which Bernstein was among the first to identify has been the subject of further subsequent examination, notably

87. Richardson, Ogus and Burrows, supra note 19; Hawkins, supra note 19.
by Quirk.\(^2\) Political foundations of US bureaucracy have also been explored,\(^3\) together with the nature of the political influences on the regulatory process.\(^4\)

The regulatory activities of the agencies themselves have also been the subject of continuing academic interest in the US, with several books having been written on the effectiveness of commission type structures,\(^5\) the role of interest groups and intervenors\(^6\) and the legitimacy of self-regulatory mechanisms.\(^7\) Some work has also been undertaken on the effect of agency procedures on the design of regulatory rules,\(^8\) although much that has been written in this area is contained in the voluminous periodical literature.

A good deal of this work is necessarily restricted in its application to the American situation, owing to the particular constitutional and institutional arrangements relating to the US regulatory agencies. However some of the research which seeks to relate particular regulatory techniques to issues of institutional design is of relevance in the UK context and will be examined in due course. In the area of environmental

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regulation, one major study of comparative regulatory methods on both sides of the Atlantic has been undertaken by Vogel and is worth noting here.\textsuperscript{99}

1.4.2 Comparative Studies

The second major area of research methodology involves comparative studies of US and UK regulatory techniques. While there are always dangers in seeking to transplant ideas from one jurisdiction to another these can be overstated. For example, objections to the use, or to the investigation of the use, of US regulatory techniques in Britain are often based on an inadequate appreciation of the nuances of the US system, on a failure to separate conceptual from operational difficulties and sometimes on little more than sheer prejudice. On the other hand there is no denying that some US regulatory methods, particularly in the areas of rule making and adjudication, do suffer from various practical problems, and the nature and causes of these will be examined in more detail in later chapters.

Part of the task of this thesis will be to identify the positive features which should be present in an improved regulatory regime, while indicating how some of the weaknesses might be avoided in the United Kingdom context. The comparative studies in this thesis play an important role when approaching this task. The studies of US regulation throw some light on difficulties with the US regulatory process at both the state and federal level and indicate how these might be minimised or avoided.

They also illustrate some of the strengths of the American system, such as its ability to compel full and accurate disclosure of regulatory information, in providing a structured time frame for regulatory participation and in instituting effective mechanisms for consumer involvement. In addition they serve to dispel some unfounded rumours about US regulation, for example that it depends unduly on costly and protracted public hearings and that the process of judicial review in American courts is largely out of control.

In the case of Commonwealth jurisdictions the comparative studies show the use which has been made of commission structures in Canada and Australia and the problems with the free market approach in New Zealand. The US and Commonwealth studies also show the increasing use of innovative regulatory techniques, including negotiated rule making, consensual procedures, arbitration and ADR processes.

1.4.3 Empirical Studies

The third major component of the thesis research methodology consists of empirical studies of UK and US regulatory bodies based on intensive field work and interviews. The UK case studies in chapter 9 cast considerable light on a number of different aspects of UK economic regulation. They show the progress to date in introducing progressive regulatory techniques and areas where further improvement can be achieved. Trends in regulatory enforcement, particularly in relation to anti-competitive behaviour, are illustrated by a detailed study of the OFTEL initiatives in this area.

The case studies of the US regulatory process in chapter 10 supplement the comparative studies of US regulation in chapter 6 and provide a concrete setting for some of the theoretical principles discussed. Contemporary US experience in areas such as regulatory hearings and settlements, judicial review and consumer intervention will be discussed in detail by reference to the activities of several state public utility commissions and consumer protection boards, together with a federal agency. Chapter 10 embodies material derived from several weeks of field work in the United States during January 1996 (and subsequently updated) and presents a contemporary picture of the current state of the US regulatory process.

The above empirical work serves to set the principles of process-oriented regulation in a practical context. The studies indicate areas where progress has been made and point to where more remains to be done.
1.5 Aspects to be Addressed in Further Detail

A new approach to regulation of the kind referred to in part 1.1 of this chapter, when directed to the achievement of the regulatory goals to be described in part 1.10 below, incorporates a number of aspects which will be considered in the course of the thesis. These can be summarised as follows:

- a requirement to adopt and follow open and transparent procedures involving full consultation and the issuing of reasoned decisions on regulatory issues;

- the need for a clear legislative mandate for regulatory action in which matters of policy, such as the comparative weight to be accorded to differing regulatory goals, are clearly expressed for the guidance of the regulator;

- the provision of sufficiently flexible regulatory powers allowing regulators the opportunity of developing a regulatory regime involving an optimal mix between the use of rules and discretion while preserving fairness and accountability;

- adequate powers of regulatory enforcement, particularly in areas where existing competition law restraints may be inadequate, such as in relation to predatory or anti-competitive market practices;

- an appropriate regime of judicial review, together with a possible right of appeal on the merits, which provides for adequate redress on the part of persons affected by an irregular regulatory decision while recognising and according reasonable deference to decisions reached by an expert regulatory body within the terms of its expertise;

- structured procedures, which are independent of the regulator and which are adequately funded and resourced, allowing for effective participation by third party interests, such as consumer groups, in the process of regulatory decision making;

- the use of innovative procedures in the resolution of regulatory issues and disputes, such as consensual procedures involving negotiation and bargaining,
and alternatives to full trial procedures such as mediation, arbitration and ADR processes;

- an institutional framework which allows regulatory bodies to pursue the objectives of an ideal regulatory regime in the context of the foregoing factors;

- a system of public and administrative law which encourages regulatory action along the above lines while at the same time providing an effective check on regulatory procedures.

Many of the above points raise issues which remain quite controversial, not only in Britain but also in the US and elsewhere. To take just a few examples:

- is a broad regulatory discretion ever compatible with concepts of accountability and the legitimate rights of regulated firms?;

- can wide consultation requirements be reconciled with the goals of regulatory efficiency and effectiveness?;

- is legislation which prescribes the comparative weight to be given to regulatory objectives inconsistent with the goal of regulatory autonomy?;

- is an expansive approach to judicial review or a right of appeal on the merits, which can lead to the views of a judge or a less specialised appellate body being substituted for those of an expert regulator, ever justifiable?;

- does the need for verification of the accuracy of information on which regulatory decisions are based outweigh the possible cost and complexity of trial type procedures?;

- should regulatory enforcement be primarily based on stringent sanctions or on moral persuasion and education?;

- should broad areas of economic regulation be subject to the discretion of a single regulatory commission?

Many of these questions cannot be adequately answered in the abstract but need to be addressed in the context of a specific regulatory situation. The empirical research
and case studies contained in the following chapters will illustrate how these issues arise and the ways in which they can be resolved.

1.6 A Brief Historical Perspective

The need for an innovative approach to economic regulation can be illustrated by the history of attempts to regulate in the economic area. This is a subject which will be examined in more detail in chapter 2, but which merits some brief discussion here.

Economic regulation in Britain has had a longstanding pedigree, extending back at least as far as Tudor and Stuart times. For several hundred years, up until the 19th century, state regulatory activity focused on the use of specific legislative prohibitions and controls on particular practices, with delegated legislation gradually increasing in significance over this period. The control of certain kinds of monopoly power came increasingly to be the subject of legislative and judicial attention. The common law developed its own techniques of control in this area at an early stage, with attempts from the 17th century onwards to define the responsibilities of those operating businesses with a public interest element. These initiatives, leading to the formulation of principles such as the requirement to provide universal service at a reasonable price, laid the foundation for the regulation of public utilities in modern times.

The Victorian era witnessed increased government involvement in a number of areas of economic and social life. An age of increasing industrialisation gave rise to unique challenges. Technical innovations such as the supply of piped gas and water, railways and later the provision of electricity and telephone services gave rise to a corresponding need for regulatory control.

In the area of social regulation, early attempts were made to relieve the plight of the poor through the introduction of comprehensive poor law legislation, administered through a commission structure. In other areas of social policy, such as child labour, education and industrial and mining safety, remedial legislation brought about considerable improvements. One of the apparent paradoxes of the Victorian era is the fact that these initiatives were pursued during an age which is often regarded as
representing the epitome of *laissez faire*, or lack of government interventionism, an issue which will be explored further in the next chapter.

The processes of economic regulation continued to be refined during the present century. The period between the wars witnessed a new phenomenon, the emerging public corporation, with early examples being provided by the BBC, the London Passenger Transport Board and the Central Electricity Board. This structure was envisaged by its designer, Herbert Morrison, as combining the pursuit of commercial objectives with public interest considerations.

After the Second World War an era of nationalisation began, which lasted for the next 40 years. Regulation by government ownership and control of major industries in Britain became the predominant model. However, contrary to what might perhaps have been expected, this approach did not succeed in solving various regulatory problems. Particular difficulties persisted in areas such as openness and accountability, efficiency and regard for the consumer interest. Finally, the trend towards privatisation in the mid 1980s brought with it a need for new approaches involving external regulatory bodies.

These developments were broadly paralleled in the case of other Commonwealth jurisdictions, such as Canada, Australia and New Zealand. In each of these countries early attempts at economic regulation, particularly in areas such as public utilities and railways, were followed in the present century by a period of reliance on public ownership as a regulatory model, to be succeeded more recently by a move to privatised ownership. Regulatory methods in these jurisdictions will be referred to in the course of the thesis where appropriate.

In the United States, events took a different course at an early stage. During the first half of the 19th century economic regulation largely took place at the state or municipal level, with localised ownership of utility companies being the norm for much of this period. Rapid industrial development and the increasing concentration of market power in the period following the Civil War led to federal legislative activity, particularly in the commerce and antitrust areas, with the passing of the Interstate Commerce Act in 1887 (which established the Interstate Commerce Commission, or ICC) and the Sherman Act in 1890.
After this, the so-called independent regulatory agencies gradually came into being, a process which received renewed impetus during the New Deal period of the 1930s. This was matched by the introduction of state public utility commissions, beginning with New York and Massachusetts in 1907, and followed quickly by the other states. The passing of the Administrative Procedure Act by Congress in 1946 ushered in a new era of regulatory intervention. Under this Act the US federal regulatory agencies were given a statutory framework in which to undertake rule making and adjudication and regulatory decisions could be subjected to judicial review on various, specific grounds.

During the 1950s concerns began to surface that the US regulatory agencies were too closely identified with the interests of the regulated industries that they were supposed to be controlling, to such an extent as to give rise to the phenomenon known as regulatory capture. The validity of this and other theories of regulatory agency behaviour will be discussed in subsequent chapters. However, it now seems fair to say that these early theories were insufficiently refined to explain adequately the complexities of the regulatory process, particularly in more recent years. In the 1960s and 1970s a new wave of regulatory activity, the so-called "new regulation", occurred in areas as diverse as environmental protection, occupational health and safety and equal opportunities, giving rise to several new regulatory agencies and a great deal of fresh activity in this area.

An era of deregulation in the 1980s led to some traditional areas of US regulation diminishing in importance while others continued on largely unaffected. Increasing disquiet about the perceived financial burden of new regulatory initiatives resulted in cost/benefit considerations being applied to proposed agency actions. Contemporary concerns about the US regulatory process have focused on the adequacy of agency procedures, particularly in areas such as rule making (which is allegedly undergoing a period of ossification), public regulatory hearings (thought to be accompanied by undue cost and complexity), and the problems which are said to arise from extensive, or excessive, use of the process of judicial review in relation to agency decisions. This debate has been accompanied by an examination of new regulatory techniques, particularly involving the use of negotiated and consensual procedures in relation to
agency rule making, and various forms of ADR and mediation in the adjudicative area.

This long experience with economic regulation by external agencies in the United States is of particular relevance in the UK context. The privatisation movement of the 1980s in Britain gave rise to the need for external regulation in the public interest, of the kind which had long been a feature of US practice. While there are differing legislative and constitutional arrangements in force in the United States, much US experience in this area is of direct relevance to the UK position and will be the subject of extensive reference in the chapters which follow. The approach adopted in the US APA, for example, has certain discernible advantages and the possible application of similar techniques will be examined further in the UK context, along with more recent US experience in the use of innovative regulatory methods.

1.7 Economic v Social Regulation?

When discussing the context of UK regulation some mention should be made of the relationship between economic and social regulation. Although some commentators endeavour to distinguish between these areas of regulation,\(^\text{100}\) the drawing of such a distinction may prove to be difficult in practice. In the US, the "new regulation" of the 1960s and 1970s was directed both at securing economic efficiency and also promoting various social goals, as will be discussed in chapter 6. Such wide-ranging regulatory activity clearly has a direct economic impact, both in terms of the costs of compliance and also because of its effect on business and investment decisions.\(^\text{101}\)

This is no less true in Britain. Social regulation in areas such as consumer protection, product safety standards, occupational health and safety regimes and control of

\(^\text{100.}\) For an example of this approach see Foster, supra note 58, chapter 9, entitled "The Dangers of Mixing Social with Economic Regulation."

\(^\text{101.}\) See for example Schuck, "Book Review of James Q. Wilson (ed), The Politics of Regulation" (1981) 90 Yale LJ 702 at p 710, where the author notes: "This is not to deny that social regulation often generates benefits: doubtless it does, although available data do not establish conclusively or even persuasively that benefits always exceed costs. The point here is that those costs are no less problematic simply because the regulation is social rather than economic. If anything, the contrary is true."
environmental pollution all have clear economic implications.\textsuperscript{102} The costs of compliance must be factored in to the overall costs of doing business in these areas. Regulatory costs also influence commercial decisions in areas such as investment, capital expenditure and market entry.

Regulatory experience in Britain reveals a number of areas of economic regulation in which considerations of social policy also play a significant part. These include the activities of the regulators of the privatised utilities and the Rail Regulator, who are required to have regard to the interest of customers and consumers when making regulatory decisions,\textsuperscript{103} the role of the Civil Aviation Authority, both in relation to air transport licensing and safety matters,\textsuperscript{104} and the involvement of the Independent Television Commission in allocating television licences while also being responsible for regulating programme content and standards.\textsuperscript{105}

This thesis focuses primarily on regulation of economic affairs but recognises that the attainment of desirable social objectives is often inseparable from this analysis. Where such considerations arise they will be dealt with in the course of the succeeding chapters.

\section*{1.8 The Existing Model of UK Economic Regulation}

As the above discussion has indicated, the need for extensive external economic regulation in the United Kingdom was not a major issue until the move to privatised ownership during the 1980s. Until then externally imposed regulatory intervention was sporadic and limited in its scope, being restricted to areas such as civil aviation and radio and television broadcasting. Other major areas of industrial activity were subject to direct government ownership and control under the then prevailing system of nationalised ownership.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{102} For a general discussion of these and other areas of social regulation see Ogus, \textit{supra} note 1, chapters 7-12.
\item \textsuperscript{103} See the discussion in part 7.6.1(ii) of chapter 7.
\item \textsuperscript{104} See the discussion in part 7.6.2(i) of chapter 7.
\end{itemize}
\end{footnotesize}
A proper appreciation of the nature of the regulatory regimes introduced during the 1980s in Britain requires some understanding of the factors underlying the privatisation process. These will be the subject of more detailed analysis in subsequent chapters. However, it is important for present purposes to realise that the political and economic agenda behind privatisation exerted a central influence on the design of the accompanying regulatory institutions. Government economic policy dictated that the privatisations should be successful and should provide a means of raising revenue to defray the public borrowing requirements of the state, while, so the theory went, simultaneously giving rise to efficiency gains in the enterprises themselves.

Political considerations required that shares in the privatised industries should be available to a broadly based, share-owning public, which would find them attractive as an equity investment. This in turn required a more or less guaranteed return, to be achieved by preserving largely intact the existing natural monopoly structure which had been a feature of these industries during the era of nationalisation. At the same time privatisation would conceivably reduce the power of organised labour, as well as making the newly privatised firms more responsive to market conditions.

The fulfilment of these conditions dictated the introduction of a regulatory regime which would not seek to assert the supremacy of other values, such as consumer protection, above the interests of shareholders and their anticipated return on investment. Regulation had to be as unintrusive as possible. While it was acknowledged that privatised entities such as British Gas and British Telecom, which were permitted to retain their pre-existing positions of market dominance, had to be subject to some form of regulatory control, particularly in relation to pricing, this was viewed as a necessary evil rather than as a potential benefit.

This philosophy was reflected in the design of the regulatory institutions themselves. These were hastily conceived, almost as an afterthought, and the resulting regulatory regime suffered from various difficulties of design. A system which in jurisdictions such as the United States had taken over a century to refine was put in place without much, if any, consideration of regulatory experience elsewhere. The individual

105. See the discussion in part 9.4 of chapter 9.
regulators were given a broad discretion on pricing issues but accompanying powers seen as necessary as a result of long experience in jurisdictions such as the United States were noticeably absent.

Thus the regulators had no independent means of assessing the accuracy or completeness of financial information provided by the regulated companies (a task accomplished in the US by means of a fully fledged adversarial hearing procedure) and the sanctions for supplying inaccurate or misleading information to the regulator were derisory in comparison with US practice. Individual industry regulators had no general rule making powers and the empowering statutes gave them little guidance on policy matters, either in relation to the particular industry or on a sectoral basis. The comparative weight to be given to various regulatory goals was largely unspecified. Powers of enforcement were generally limited and the general competition law provided little assistance in this area. Mechanisms for involving consumers or other third parties in the regulatory process were of doubtful effectiveness. Many of these criticisms continue to apply as cogently in 1997 as they did ten years ago.

With the move towards greater industry competition, especially in telecommunications, electricity and gas, the focus of regulatory concern has broadened to include measures necessary to address structural problems in the market. Anti-competitive practices by dominant operators have become a focus of regulatory interest, especially in relation to telecommunications and gas. Such concerns have been particularly cogent in areas such as interconnection (allowing competitors access to the existing industry transmission or distribution network) and accounting separation (the provision of accounting rules designed to ensure that dominant firms cannot structure their business so as to subsidise prices in certain areas of competitive activity, thus creating artificial barriers to market entry).

Bodies such as OFTEL have perceived a need to become active in the enforcement area in relation to such practices. This in turn has required adequate powers of enforcement, which are conspicuously lacking under general UK competition law. Regulatory bodies in Britain are now tending to adopt a more interventionist role in the area of economic regulation. Enforcement mechanisms which reflect this change
of emphasis, while still meeting the goals of an ideal regulatory regime as far as possible, have therefore been required. In succeeding chapters this thesis seeks to evaluate the success of attempts to develop such processes in Britain.

1.9 The Justifications for Economic Regulation

1.9.1 Why Regulate?

Before considering the objectives of an ideal system of economic regulation it is legitimate to ask - why regulate at all? The fact that governments of modern market-based economies have invariably chosen to pursue some degree of external control of economic activity does not satisfactorily answer this question because the legitimacy of such government action is not universally accepted. Even where the need for external intervention is accepted, there is often little unanimity on the best method to adopt. Given that western governments of all political persuasions have seen fit to adopt a similar course in this area, albeit with varying degrees of enthusiasm, this does suggest that there must be some common justification or justifications for such an approach at the level of fundamental economic and political theory. These justifications will now be examined.

1.9.2 Justifications Based on the Need to Control Monopoly Power

(i) The Theory

Commentators in this area generally agree that the need to control monopoly power constitutes one of the major justifications for externally imposed economic regulation. This ground for regulatory intervention is based on the perceived necessity of preventing industries or firms in a position of monopoly power from taking advantage of their favourable market position by raising prices or restricting output without the limiting effect of competition. As basic economic theory demonstrates, where there is a single monopoly supplier of goods or services, or a small number of oligopolistic suppliers, those parties are in a position to extract monopoly or oligopoly super profits if unrestrained by either competition or state
regulatory intervention. Commentators such as Breyer and Stewart have concisely summarised the applicable rationale here.

Other writers on economic regulation express similar sentiments. Economists and others often remark that the need for regulation will disappear as a market moves from a situation where it is dominated by a handful of major players to one in which there is full competition. Such an assertion is valid so far as it goes but tends to overlook the fact that in the real world, practice is often somewhat divergent from theory.

(ii) Will Increasing Competition Replace Regulation?

Experience with the operation of competitive markets illustrates that the desire to achieve market domination is a strong one. Observers of the market, from Adam Smith onwards, have noted that the temptation to acquire monopoly power, or at least a position of market dominance, has often proved too strong for market participants to resist. A supplier in a dominant market position may even attempt to enlist the aid of the regulatory process.


107. See Breyer and Stewart, Administrative Law and Regulatory Policy, supra note 40, pp 6-7: "Under these conditions [of natural monopoly], regulation aims in part at 'allocative efficiency'. To the extent that prices are set at levels approximating those that would exist under competitive conditions, they more accurately reflect the comparative costs of real resources used. Consumers are not led, by an artificially (monopolistically set) high price for Product A to substitute Product B (which in terms of real resources costs the economy more to produce)...The economic debate concerning whether regulated prices will avoid allocative waste is complex. But in any event, the rationale for regulation of monopoly power rests not on economic claims alone, but also on other objectives such as fairer income distribution, avoiding discrimination in price or service among customers, and distrust of the social and political (as well as the economic) power of an unregulated monopolist."

108. See for example Breyer, Regulation and its Reform, supra note 68, pp 15-16; Ogus, supra note 1, pp 29-33; Waterson, "Allocative Inefficiency and Monopoly as a Basis for Regulation" in Sugden (ed), supra note 53, chapter 2; Mitnick, supra note 1, chapter 1.

109. See Adam Smith, The Wealth of Nations, (Cannan (ed), Univ of Chicago Press, 1976, 1st ed published 1776) who referred at Book IV, p 165 to laws "....which the clamour of our merchants and manufacturers has extorted from the legislature, for the protection of their own absurd and oppressive monopolies." See also Galbraith, The New Industrial State
Such a firm might take the view, possibly with considerable justification, that it is better to strike a tolerable deal on pricing issues with a regulator in exchange for the preservation of an existing market structure, rather than risk the inevitable erosion of monopoly profits that would flow from unrestricted market entry by competitors. Furthermore, free entry into a fully competitive market may not necessarily assure the attainment of desirable social objectives such as universal service and non-discrimination. 'Cherry picking', or 'cream skimming', in which firms compete for the most desirable customers in a particular market and neglect or ignore the others, is not an unknown phenomenon in recent UK experience. Indeed the occurrence of such practices is quite consistent with what might be expected to occur in a free market consisting of profit-maximising participants.

Recent experience, both in the United Kingdom and elsewhere, serves to illustrate the above discussion. To take a topical example, the deregulation of the local bus transport industry in Britain has not been universally successful in terms of promoting the interests of consumers of bus passenger services. The practical result of unrestrained competition combined with a lack of externally imposed regulation in this area has been the emergence of highly undesirable market practices, in which

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(Houghton, Mifflin Co, Boston, 4th ed, 1985) at p 196: "What the theory asserts as to the paramountcy of the market, the law affirms. Enforcement is announced or promised or demanded. The susceptible, and those who love the market as a mistress, can persuade themselves that it is being restored or could be restored. The fig leaf by which power is kept out of sight is held in place not only by economists but by the statutes of the United States and the decisions of its courts."; and Olson, The Rise and Decline of Nations: Economic Growth, Stagflation and Social Rigidities (Yale UP, New Haven, 1982), pp 177-180, who expresses the view that laissez-faire policies involving an absence of government intervention in the market lead eventually to a concentration of market power into cartels and dominant participants through lobbying from special interest groups.

110. This brings to mind the observation of Sir John Hicks that "the greatest monopoly profits are a quiet life". See Hicks, "The Theory of Monopoly: A Survey" [1935] Econometrica 1.

111. In the US context both railway companies and air transport operators have been accused of capturing the regulatory process to further their own ends. In relation to the former see Kolko, supra note 66. On the latter see Breyer, "Regulation and Deregulation in the United States" in Majone (ed), supra note 3, chapter 1, pp 15-16. Established professions such as law, medicine and accountancy are also frequently accused of making use of licensing or accreditation processes to entrench their position by restricting entry to the profession in question. For a discussion of this area see Ogus and Veljanovski, supra note 19, pp 267-272; Pfeffer, "Administrative Regulation and Licensing: Social Problem or Solution" (1974) 21 Soc Probs 468.
Certain aggressive bus operators have endeavoured, often quite blatantly, to corner the market and drive out competitors, often by both fair means or foul.\(^{112}\)

Similarly, the desire to preserve an existing position of market dominance is reflected in the strategy adopted by some dominant suppliers in relation to interconnection issues, where the owner of an existing distribution or transmission network may seek to use every means at its disposal to delay or frustrate attempts by competitors to achieve interconnection on a rational and expeditious basis. The telecommunications industry, both in the UK and elsewhere, affords recent illustrations of such undesirable market practices.\(^{113}\)

(iii) Is the Free Market Approach Adequate?

Adherents of the free market view tend to approach these issues by addressing the question of barriers to market entry. Some writers go so far as to assert that antitrust or competition law principles should adopt such a general perspective rather than addressing particular instances of market failure.\(^{114}\) While such an approach is...

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\(^{112}\) See the discussion of the deregulation of the local bus industry in part 7.5 of chapter 7.

\(^{113}\) See the discussion of interconnection difficulties in the UK telecommunications industry in part 9.6.5 of chapter 9. Dr Keith Monserrat, Director of Operations for Scottish Telecom plc, described some of the interconnection problems which his company had experienced in gaining access to BT's network in the following terms at the OFTEL public hearing on 23 November 1995: "...we, as the new operators, want to move up that value added chain and provide connectivity to the differentiated services. Consequently, we require more than just the telephony interfaces. We require peer to peer connectivity, rates and costs. Currently, this is determined by BT for access to their network....the supplier controls the time to launch [new services] and consequently adds an unfair constraint to the new operator. This all leads to an inequality in bargaining power with the dominant operator." (OFTEL transcript of public hearing of 23 November 1995, pp 62-63.) The New Zealand experience with interconnection difficulties in a largely unregulated telecommunications market is discussed in parts 4.6.2 to 4.6.4 of chapter 4 and part 11.3.2 of chapter 11 and has also been the subject of recent litigation before the Privy Council in Telecom New Zealand v Clear Communications [1995] 1 NZLR 385.

\(^{114}\) See for example Epstein, supra note 48, pp 126-127: "As before, the best protection against illicit concentration [of market power] is the removal of restrictions against entry into national and international markets; and the tedious, expensive, and unreliable process of reviewing mergers may only retard that desirable practice. The best rule is again the simple one: if the parties are prepared to incur the expense of some permanent corporate rearrangement, no legal force should oppose them... And there is little reason to muster heavy ammunition to dissolve cartels that are likely to collapse quickly of their own weight. The necessity principle scarcely requires the erection of a complex body of antitrust law that is far too likely to go astray." For similar criticisms of the US antitrust laws see Posner, supra note 48,
admirable in its theoretical simplicity, it conveniently overlooks the fact that unrestricted market entry in itself may not provide a complete answer, or even any sort of answer, to problems of market failure.

An aggressive local bus company which deliberately embarks on a systematic strategy of putting rival operators out of business by predatory pricing and other forms of sharp practice is unlikely to be deterred by the fact that other competitors can enter the market. New entrants will simply encounter the same treatment, apart from which there are often practical limits to how many firms can effectively participate in a particular market, such as that for local bus travel. (At the level of logical absurdity, individual bus routes and stops would be choked with buses from hundreds of different operators and ensuring low barriers to market entry would be the least of the industry's problems!) Recent UK experience has shown that blatantly anti-competitive conduct is far from being a purely hypothetical problem.\textsuperscript{115} Furthermore, an unrestricted right of market entry is of little value if an intending market entrant is unable to gain expeditious access on reasonable terms to the dominant party's existing distribution or transmission network.\textsuperscript{116}

It may be of course that exponents of the free market approach envisage unrestricted market entry as including the freedom to operate without having to overcome

\begin{footnotesize}
\begin{enumerate}
\item[115.] Indeed, behaviour of this very kind was identified by the Transport Committee of the House of Commons in its \textit{First Report on the Consequences of Bus Deregulation} (HMSO, London, 22 November 1995), Volume I, paragraphs 25-35; 42-46; 62-66; 134; 143. The Committee noted at paragraph 44 in particular: "Some companies had received threats, direct or implied, to keep out of an area or face being run off the road in a predatory retaliation. However, more common forms of predatory behaviour were to swamp an area with buses in order to reduce an incumbent's revenue and to cut fares or even to charge no fares at all. This occurred in Darlington where a Stagecoach subsidiary offered free bus services for a period of five weeks as a component in its competitive strategy." See also the discussion in parts 7.5.2 to 7.5.3 of chapter 7.
\item[116.] In relation to the privatised utilities this is likely to prove a continuing problem where one firm continues to have a natural monopoly at the supply stage, as in the case of electricity and gas. See for example Waterson, "The Future for Utility Regulation: Economic Aspects" in Corry, Souter and Waterson, \textit{Regulating Our Utilities} (IPPR, London, 1994), p 103 at p 115: "...the problem of the utilities has not disappeared, and will not do so. The promise of competition is not a promise without monopoly at a stage of supply, and that is enough to constitute a monopoly problem. The regulators are not shrinking in size; if anything the opposite is currently occurring."
\end{enumerate}
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predatory pricing, lack of available interconnection rights and similar forms of anti-competitive behaviour.

However, such theorists immediately encounter a conceptual difficulty, in that anti-competitive practices of the kind referred to above can often only be tackled by appropriate remedial legislation. Far from removing the need for antitrust or competition law, the free market approach may simply affirm it, given the commercial reality that not all those in business are saints, that those in a position of market dominance will often do everything in their power to retain it and that those who aspire to such a position may do all they can to achieve it.

Given this situation, the need for some form of external state intervention to control monopoly power is likely to persist even in an ostensibly competitive market.\(^{117}\) Opinions may well differ, of course, on the appropriate level of such intervention. In particular, should a regulatory regime be "light-handed" (perhaps relying on a regulator with limited powers, or on the general competition law\(^{118}\)), or should the regulator possess strong powers of enforcement combined with a good deal of individual discretionary power in relation to regulatory decisions?\(^{119}\) Governments may of course exercise ultimate regulatory authority through public or nationalised forms of ownership and control, although such mechanisms are currently less

\(^{117}\) This is not to underestimate the difficulty of the task facing a regulator which must assess whether the pricing structure of a monopolist compares favourably with what might be achievable under conditions of competitive pressure. See for example the discussion in Rowley, Antitrust and Economic Efficiency (Macmillan, London, 1973), who notes at p 72: "If firms always combined their factor inputs efficiently and produced at minimum cost, if the prices of factor inputs always reflected their opportunity cost, and if the accounting ledgers of the firm accurately reflected the costs incurred, the task of the regulatory commission, though difficult, would be manageable. Merely to indicate these requirements is to underline the immensity of the real-world problems faced by regulatory commissions."

\(^{118}\) The UK system of economic regulation of the privatised utilities is sometimes described as being "light-handed" in nature as the ultimate power to bring about significant regulatory decisions, such as licence amendments, rests with the MMC rather than the industry regulator. Few jurisdictions have been prepared to allow economic regulation to be governed principally by the general competition law, although New Zealand has been an exception to this rule. See the discussion in parts 4.6.2 to 4.6.4 of chapter 4.

\(^{119}\) Such an approach tends to represent that adopted in the US, as the discussion in chapter 6 illustrates.
fashionable in non-collectivist western economies. However issues as to the design of regulatory rules cannot be divorced from the structure of the regulatory regime which is to be adopted.

1.9.3 The Need to Control Excessive Profits as a Justification for Regulation

The perceived need to control excessive or windfall profits is sometimes perceived as being another form of market failure justifying external economic regulation. Regulatory methods based on this ground differ. They may range from various forms of price control to the imposition of particular tax burdens.

1.9.4 The Need to Correct for Externalities/Spillover Costs

The problem of "externalities" or "spillover" costs is often perceived as another justification for economic regulation. In terms of basic economic principle, an externality is a transaction cost incurred by members of society, or a benefit received by them, which is not taken into account by the parties to the transaction as it does not directly concern them in their dealings with each other. Common examples of externalities are processes which give rise to pollution or other undesirable environmental effects. For example, a manufacturing process may produce smoke emissions which lead to the formation and depositing of acid rain in another part of

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120. See for example the views of Waterson, supra note 116 at pp 119-120: "...surely there is a case, on grounds of the potential for coordinating policies (say across energy in general, or transport) as well as reducing monopoly power held privately, for removing certain core elements of the regulated industries into public hands again. The most obvious candidates are the National Grid and its equivalent in gas."

121. See for example Breyer and Stewart, supra note 40, p 7 (citing the regulation of oil prices following the OPEC oil shocks of the 1970s); Breyer, supra note 68, p 19.

122. An example of the latter in the UK context is the current proposal, much debated in the financial press, for a "windfall tax" on what are said to be the excessive profits of some of the privatised utilities companies.

123. From the perspective of economic theory, see the discussion in Lipsey, supra note 106, pp 401-402.
the country, or even in a neighbouring country, causing significant damage to forest resources or arable land.

Such a cost is likely to be remote, both in terms of geographic separation and the possibility of apportioning tortious liability, from the originator of the pollution and in a free market situation would not need to be considered by that party. In fact, the application of traditional economic theory would lead to criticism of a manufacturer that voluntarily installed anti-pollution equipment in its factory as this would not represent profit-maximising behaviour on the part of the enterprise in question.

Other externalities which are commonly quoted are the expense of providing various public goods, such as collective security by way of a system of national defence, police, fire-fighting and similar community services which cannot conveniently be made available on a selective basis so as to exclude safety "free-riders." Controls over other externalities may be less obvious, such as compulsory seat belt or motorcycle helmet laws and prohibitions on littering. The advantage of government regulation in this area is that it overcomes the difficulties associated with individuals who might otherwise have to attempt to enter into co-operative arrangements of their own initiative. The application of mandatory external regulation serves to overcome problems of individual bargaining in the correction of externalities, and avoids possible problems of cheating among affected individuals.

In the context of economic regulation a number of perceived externalities arise. Nearly every significant regulatory policy or decision gives rise to flow-on effects in other areas, many of which may not be obvious at the time. A regulatory decision to encourage usage of electricity rather than coal may be a significant factor in causing unemployment and structural collapse in the coal industry, accompanied by increased welfare expenditure and the disintegration of local communities. Encouraging unrestricted, if not cut-throat, airline competition may lead to a diminution in safety levels and reduced expenditure on preventative maintenance, to the potential

124. See the discussion in Ogus, supra note 1, pp 33-38.

125. For further discussion of this justification for economic regulation see Breyer and Stewart, supra note 40, pp 7-8 and chapter 8; Breyer, supra note 68, p 23; Sappington and Stiglitz, "Information and Regulation" in Bailey (ed), supra note 95, chapter 1.
detriment of passengers, air crew, and persons living beneath busy air routes. The water industry subsidises the polluting effects of agricultural and industrial activity on the water supply by its purification programmes for drinking water.\(^{126}\)

Privatising a national rail network into numerous individual operating companies which lease track and infrastructure from a separate provider of these items at market rates may discourage publicly desirable expenditure on customer amenities, such as improved stations, facilities and even lighting for station access ways. A train operator which would otherwise be willing to provide such improved facilities may be discouraged by the prospect of having to pay increased user charges, an example which is far from being hypothetical in nature in the UK context.\(^{127}\)

Perhaps the most notorious example of externalities in the context of privatised rail is the somewhat bewildering sight of motorway users banked up for miles behind a truck slowly transporting a railway locomotive for maintenance.\(^{128}\) Many rail operators apparently find it cheaper to adopt this method of transport rather than towing the locomotive along the railway track and thereby incurring substantial Railtrack user charges. While using the roads in this way causes massive congestion, heightened levels of public frustration, the cost of a police road escort, and hugely increased wear and tear to the road surface, these costs are borne by the public and the taxpayer, not the rail operator involved. Externalities are therefore far from being

\(^{126}\) Glaister notes in "Incentives in Natural Monopoly: The Case of Water", in Beesley (ed), *Regulating Utilities: A Time for Change?* (IEA, London, 1996) on the subject of externalities in the water industry at p 29: "The water industry is riven with externalities. Domestic water consumers pay for the removal of pesticides which are a consequence of profit-seeking behaviour of the agricultural industry and of public subsidies on agricultural output which provide an incentive to their greater use. So water consumers are subsidising farmers in their roles as water consumers, food consumers, and, additionally, as taxpayers... It seems that domestic householders have to bear these costs purely as a matter of history and expedience."

\(^{127}\) On this subject see the collection of case studies on UK rail privatisation in Wolmar, *The Great British Railway Disaster* (Ian Allan Publishing, Shepperton, 1996). This collection of 64 failings of the privatised rail network, originally published in the *Independent on Sunday*, is not unamusing (except for those passengers involved) and will be referred to in subsequent chapters. On the subject of reluctance to effect improvements in facilities because of the prospect of having to pay higher usage charges to Railtrack as a consequence see case studies 4 (p 20) "So You Want to See Your Way at Night?", 11 (pp 34-35) "So Railtrack is Being Privatised?", 16 (pp 46-47) "So You Want to Use the Toilet? (Part 2)", 39 (pp 92-93) "So You Want a New Station?", 50 (pp 114-115) "So You Want to Open a New Station?" and 55 (pp 124-125) "So You Want New Trains?"

\(^{128}\) *Ibid* case study no. 38, pp 90-91: "So That's Why the Motorways are Taking the (S)Train?"
of mere theoretical significance to economists. They often go to the heart of the regulatory process itself.

1.9.5 Protection of Third Parties Such as Consumers.

In one sense the protection of third party interests, such as those of consumers, employees and the environmental interest groups, can be seen as specific examples of externalities of the kind referred to in the previous category. However because these interests have a central place in the regulatory process they merit separate mention here. The position of consumers is particularly relevant. Periodic criticisms have been advanced of the process of UK regulation in terms of its alleged tendency to favour the interests of shareholders over consumers, particularly in relation to pricing issues.129

There is no doubt that the interests of these two groups conflict in obvious ways. Stringent regulatory intervention can directly reduce the returns to shareholders while providing reduced prices for consumers. Light handed regulation often tends to be comparatively more favourable to shareholders. A good deal of the discussion in the following chapters will concern the ways in which existing regulatory methods affect the interests of third parties and what the optimal balance should be in this area.

1.9.6 Compensation for Inadequate Information as a Justification for Regulation

Economic theory recognises the fact that a competitive market will only function adequately where consumers of goods and services have sufficient information to enable them to make informed purchase choices. This in itself is a further justification for regulation, as Breyer and Stewart have observed.130

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130. See Breyer and Stewart, * supra* note 40, p 8: "The market for information is imperfect, however. Consumers as a class have an interest in obtaining information, but there is no
Regulation in this area is often based on the provision of sufficient information to the market in relation to particular products. Such information may relate not only to price but also to aspects of quality, composition and servicing of a particular product. These requirements are often reflected in consumer protection statutes of various kinds. In the context of economic regulation, the supply of adequate information to the regulator is necessary to enable the regulatory process to work effectively.

In the United States, regulatory bodies such as state public service commissions, which are involved in rate-setting activities, have the power to require a regulated entity to make full discovery of all of its financial and other relevant records. This information can be used at a public rate-setting hearing and can be tested by cross-examination and through the use of expert evidence adduced by the regulator. Stringent criminal penalties are available if the information provided is found to be inaccurate or misleading.

Industry regulators in Britain often have statutory powers to request the provision of financial and other information. The regulatory body can conduct its own analysis of this information. However, under the UK system, the regulators are dependent to a greater degree on the integrity of the companies themselves in terms of the provision of comprehensive and accurate regulatory information. A regulator's ability to test the accuracy of the information supplied is less pronounced than under the US system. In return for this disadvantage the UK regulatory system functions on a less formal, and probably less costly, basis.

However, it is important to appreciate that there may be a direct trade-off between convenience and expedition on the one hand and regulatory effectiveness on the other.

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131. For a general discussion of this kind of consumer protection legislation, see Ogus, supra note 1, chapter 7; Breyer, supra note 68, pp 26-28.

132. See the discussion of the US system in part 6.4.1 of chapter 6, part 8.3.2 of chapter 8 and part 10.3 of chapter 10.

133. For a summary of these powers see the discussion in part 7.4.6(iii) of chapter 7.
other. This can especially be the case in relation to rate-setting and price-capping exercises and regulatory attempts to detect the existence of elements of cross-subsidy in regulated firms. These factors will be discussed in more detail in subsequent chapters.

1.9.7 Justifications Based Upon the Need to Eliminate Excessive or Inequitable Competition

This ground for regulatory intervention is related to the need to control monopoly power as discussed in part 1.9.2 above. An industry may suffer from excessive or unfair competition, manifested through market practices such as predatory pricing or aggressive market behaviour. Such a situation may result eventually in a monopoly or oligopoly market structure, with the attendant need for regulation referred to above. Regulation in this area often consists of enforceable antitrust or competition legislation, although existing UK legislation in this area has been widely criticised as inadequate. In the United States context, industries such as air transport, trucking, ocean shipping and milk production have from time to time been identified by some commentators as suffering from excessive competition and requiring regulation as a consequence.

134. For a discussion of this phenomenon in the UK context see the text accompanying note 115 supra, dealing with the UK local bus industry. See also the more theoretical discussion in Swann, "The Regulatory Scene" in Button and Swann (eds), supra note 5, chapter 1 at p 9: "One version of the argument applies in the case of industries with heavy and specialized fixed investment and relatively low operating costs. Railways are cited as a case in point. Such industries are said to be prone to price-cutting when business conditions deteriorate as a result of a recession or over-capacity... Ultimately there emerges a monopoly which will be able to determine price without fear of being undermined by inconvenient competitors. In both these cases the consumer may enjoy a short-term benefit, but will pay for it in the long run."

135. See the discussion in part 7.9 of chapter 7.

1.9.8 Other Justifications for a Regulatory Regime

Several other miscellaneous justifications for economic regulation have been advanced. These include the need to overcome temporary or permanent market scarcity and problems of market co-ordination and planning and the need to resolve structural difficulties in a particular market or industry.\(^\text{137}\)

It is interesting to note, in this context, that British economic regulation, particularly of the industry-specific variety employed in relation to the privatised utilities, has been criticised on the grounds that its focus on individual industries leads to a lack of coherence and overall policy co-ordination at a sectoral level.\(^\text{138}\) Such a criticism, which may be justifiable at least in part, reflects a particular difficulty with present methods of UK economic regulation, which are sometimes commended for being flexible and "light-handed", but which may fail to address wider problems such as lack of co-ordination and sectoral coherence. These issues will be addressed further in subsequent chapters.

1.10 Some Benchmarks for Assessing Regulatory Performance

1.10.1 The Objectives of an Improved Regime of Economic Regulation

In considering issues of regulatory design, some consideration needs to be given to the objectives that are desirable in an ideal system of economic regulation.\(^\text{139}\) These are set out as follows, not necessarily in any particular order of importance:

\(^{137}\) For a discussion of these grounds see Swann, supra note 5, pp 10-11; Ogus, supra note 1, pp 41-46; Breyer, supra note 68, pp 32-34; Breyer and Stewart, supra note 40, pp 9-11.

\(^{138}\) See Helm, British Utility Regulation: Principles, Experience and Reform, supra note 57, pp 156-161.

\(^{139}\) In listing the objectives in this part of the chapter I have had regard to the five criteria for the assessment of the legitimacy of agency action set out in Baldwin and McCrudden, supra note 16, chapter 3 at p 33, where the authors observe: "When there is talk of this or that agency action being legitimate or illegitimate, in the sense that certain values are satisfied or left unsatisfied by agency action, reference appears to be being made to one or more of five key criteria: Is it supported by legislative authority? Is it otherwise accountable? Does it carry out its tasks with due process? Is the body expert? Is it efficient?" I have also considered the criteria set out in Foster, supra note 58 at p 417.
• **Certainty** - An ideal regulatory regime must, as far as possible, deliver an assured result in any particular context. Such a goal is necessary in the area of economic regulation in order to facilitate forward planning by regulated entities and to achieve the degree of predictability required for the conduct of business and the making of investment decisions. In practice the attainment of this objective requires either a clear legislative mandate to the regulatory body in question or sufficiently specific rules or guidelines for that body to follow. The grant of wide discretionary powers to a regulator without accompanying guidelines for their exercise may not be compatible with this goal.

• **Accessibility** - The ideal regulatory regime must be open and transparent and must encourage and facilitate participation by interested parties. It needs to ensure the provision of adequate information to interested parties on the regulatory issue to be determined and to provide a suitably structured process to enable meaningful participation to occur, either by way of known consultation procedures or similar mechanisms. Such interested parties need not be only the regulated interests themselves or members of the regulated industry but might also be other third party interest groups such as consumer organisations. The balance to be struck here is not an easy one to define. On the one hand the procedures employed must not be so exhaustive so as to cause the regulatory process to become bogged down irretrievably or to

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140. For a further discussion of the objective of certainty see Noll, "Government Regulatory Behaviour" in Noll (ed), *supra* note 4, at p 22: "Solutions [to the problem of regulatory failure] include: ... clear legislative mandates that are regularly reviewed... ". See also Cranston, "Regulation and Deregulation: General Issues" (1982) 5 UNSW LJ 1 at 11: "Regulation is only as strong as its legislative mandate however well-endowed with resources and dedicated to legislative purpose a regulatory agency might be or however compliant those being regulated... Many instances of 'regulatory failure' are in fact a failure to achieve a legislative mandate which, despite popular perceptions, a regulatory agency was never given." Foster, *supra* note 58, at p 417 describes this requirement in terms of the need for "definitions of regulatory offences which enable regulators to concentrate on the critical economic issues".

141. Foster, *supra* note 58, at p 417 postulates the need to provide "enough information ... on a routine basis to enable the Regulator to do his job without protracted, inconclusive wrangles over data" and the need to provide "procedures that conform to natural justice without being legalistic."
undermine the independent expertise of the regulatory body concerned. On the other hand the procedures need to be sufficiently effective to ensure the attainment of this goal.

- **Effectiveness** - A system of regulation must be effective in achieving its objectives. This requirement differs from that of efficiency, set out below, in that the latter requirement implies considerations such as value for money and procedural adequacy. While an effective system will probably embody such features, it is possible to envisage a system which functions efficiently at a technical level but which nevertheless fails overall to deliver the results to be expected from a truly effective regulatory approach.

- **Efficiency** - The regulatory regime must function with an adequate level of efficiency. This entails both the need for reasonable expedition in the regulatory process and the provision of responsive and flexible regulatory procedures that not only reflect the aims of the regulatory regime but are also sensitive to the needs of the regulated industry and its particular business circumstances. Again a balance needs to be drawn here between efficiency as a goal in itself and other objectives, such as that of fairness, which are

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142. The perceived problem is described by Ogus, *supra* note 1, at pp 114-115 in the following terms: "'Open' rule-making procedures might inhibit attempts at cost-benefit analysis and reduce the importance of independent, expert judgments. There is an inherent difficulty in adapting an adjudicatory framework to the complexities of rule-making and in deciding who should have participation rights. Nor should it be forgotten that American-style procedures generate substantial administrative costs and delays. The extent to which 'open' procedures can be used to enhance or, conversely to control, the influence of private interest groups is uncertain."

143. Foster, *supra* note 58, at p 417 refers to this aspect in terms of the requirement to provide sufficient regulatory information (see note 141, *supra*) and the need to allow "enough discretion for the Regulator to develop and use specialized knowledge." For a discussion of some of the difficulties inherent in assessing the efficiency of a regulatory regime see Baldwin, *Regulation in Question: The Growing Agenda* (Merck, Sharp & Dohme, London, June 1995), pp 107 - 118. See also Ayres and Braithwaite who note in their book, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford UP, Oxford, 1992), at p 4 that: "Responsive regulation is distinguished (from other strategies of market governments) both in what triggers a regulatory response and what the regulatory response will be. We suggest that regulation be responsive to industry structure in that different structures will be conducive to different degrees and forms of regulation. Government should also be attuned to the differing motivations of regulated actors. Efficacious regulation should speak to the diverse objectives of regulated firms, industry associations, and individuals within them." On the general concept of responsive law see also Nonet and Selznick, *Law and Society in Transition: Toward Responsive Law* (Harper & Row, New York, 1978).
identified below. As the US Supreme Court has observed on at least two occasions, convenience and efficiency are not necessarily synonymous with democratic procedures.  

- **Accuracy** - An ideal regulatory regime must be designed so as to reach the optimal or "correct" result, bearing in mind the applicable legislative, economic and political framework. Such a requirement involves the regulator making full use of his or her particular regulatory expertise in the area in question. The issue of what the correct outcome is in any particular case may of course be controversial, but the regulator must be able to show that the decision in question has been reached on the basis of adequate supporting evidence and is justified by reasoned conclusions.

- **Fairness** - The regulatory regime must strike a fair and equitable balance between the interests of competing elements in the regulatory process, such as shareholders, regulated firms and consumers, while employing the transparent procedures identified under the heading "Accessibility" above. In the context of the public utilities substantive requirements of fairness include the need to provide universal service without discrimination and at a reasonable price.

144. See for example *Bowsher v Synar* 478 US 714, 736 (1986) where the US Supreme Court observed (quoting from the earlier case of *INS v Chadha* 462 US 919, 944 (1983)) [:"... the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution. Convenience and efficiency are not the primary objectives - or the hallmarks - of democratic government." See also Mayton, "The Possibilities of Collective Choice: Arrow's Theorem, Article I, and the Delegation of Legislative Power to Administrative Agencies" [1986] Duke LJ 948.]

145. *Foster*, *supra* note 58, at p 417 describes this requirement in terms of the use of specialised expert knowledge by the regulator - see the passage quoted in note 143, *supra*.

146. For a general discussion of aspects of this objective see *Foster, Natural Justice and the Process of Natural Monopoly Regulation* (CRI Discussion Paper No. 9, London, 1994). *Baldwin*, *supra* note 143 at pp 123-124 identifies the goal of fairness with consistency and predictability of regulatory action, although I have preferred to treat these latter objectives under the separate heading of "Certainty" in my listing of regulatory goals. However, these concepts are undoubtedly closely related and the adoption of procedures designed to bring about a fair result should also promote the achievement of certainty in the regulatory context.
**Enforceability** - The regulator must be given adequate powers to enforce regulatory decisions against parties that are subject to the regulatory process.\(^{147}\) In the UK context this requirement will be the subject of particular scrutiny in later chapters given various perceived deficiencies in the existing state of competition law in Britain, particularly from the perspective of its relative inability to exercise effective control over anti-competitive market practices.\(^{148}\) Enforcement strategies can vary greatly in practice, ranging from the use of persuasion, education and warnings to heavier penalties, such as regulatory suspensions, civil or criminal penalties and ultimately the revocation of a franchise or licence.\(^{149}\) The efficacy of various regulatory enforcement strategies will be considered in some detail in the course of this thesis.\(^{150}\)

**Accountability** - Under a democratic system of government, regulators must be able to be held accountable to the appropriate legislative authority. While methods of accountability differ in various jurisdictions the essential principle remains the same.\(^{151}\) In the United Kingdom, economic regulators vary in their degree of independence from government. The regulators of the privatised utilities and of rail transport and television broadcasting enjoy a relatively high degree of independence, whereas other regulatory bodies such as the Civil Aviation Authority and the Director of Passenger Rail Franchising have a lesser degree of autonomy from the state.

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\(^{147}\) See for example the criterion advanced by Foster, *supra* note 58, at p 417 who refers to the need for "appropriate penalties the regulator can enforce."

\(^{148}\) See the case study in parts 9.6 and 9.7 of chapter 9 relating to the proposed OFTEL licence condition dealing with anti-competitive behaviour in the UK telecommunications market.

\(^{149}\) For a general description of the range of available enforcement strategies see Ayres and Braithwaite, *supra* note 143, chapter 2; Baldwin, *supra* note 8, chapters 5-6.

\(^{150}\) See in particular the discussion of this area in chapters 7, 9 and 11.

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- **Autonomy** - This refers to the degree of regulatory independence enjoyed by a regulatory authority. To a certain extent it is the converse of the previous requirement, given that the greater the degree of autonomy conferred on a regulator, the lesser is the level of accountability that is likely to be present in the relationship between the regulatory body and the legislature. A reasonable level of regulatory independence is thought to be essential to the development of regulatory expertise and the ability to fulfil the regulatory function adequately. However excessive autonomy, or autonomous powers that are exercised imprudently or expansively by a regulator, can give rise to criticism. In the US context the independent regulatory agencies have sometimes been referred to as the "headless fourth branch" of government for such reasons.152

1.10.2 Reconciling these Regulatory Objectives

Some reflection will serve to demonstrate that the above objectives of an ideal regulatory regime may be difficult to attain in practice and may indeed conflict with each other under certain circumstances. For example, a requirement of accessibility, which emphasises the use of open and transparent regulatory procedures (which may also be quite time consuming), may conflict with a requirement of efficiency, which could require certain kinds of regulatory action to be taken urgently or within a tightly defined time frame.

Similarly the goal of certainty may also conflict with that of enforceability, especially where the latter objective is pursued through the use of discretionary regulatory powers, the outcome of which may not be completely predictable in any particular case. Indeed, discretionary powers may be intended to confer greater scope for enforcement on the regulatory body in 'grey areas', where certainty in the application of the regulatory process is lacking. Requirements of fairness and efficiency may

152. See the discussion in part 6.2.4 of chapter 6. The question of autonomy is bound up with the breadth of appeal rights and the scope of judicial review in relation to regulatory decisions. For a general discussion of these issues see Baldwin, *supra* note 143, pp 120-122. The scope of rights of appeal and review in this area will be discussed in more detail in subsequent chapters, particularly in chapters 6-10.
also be mutually opposed and efficiency and effectiveness are not necessarily synonymous. Finally, the more obvious potential conflict between accountability and autonomy has already been referred to above.

1.10.3 The Relevance of the Economic and Political Background

In addition to these potentially conflicting goals, issues such as the optimality or correctness of a regulatory decision can only be assessed in the context of a particular economic or political theory. One person's conception of regulatory efficiency may well represent another's arbitrary coercive power. Someone who believes that all forms of government intervention in economic affairs are undesirable in themselves will be unlikely to praise a stringent regime of economic regulation, however much others may regard its effects as beneficial. An economic or political theory that emphasises collective, rather than individual, values may well ascribe a lower value to economic efficiency which is achieved at the expense of social objectives. On the other hand a system that emphasises the central importance of private (or privatised) ownership may tend to support a regulatory approach that promotes the interests of shareholders and industry, rather than those of consumers, employees, or other third party interests.

Furthermore, the political options here are not merely a stark choice between pursuing collectivist goals and espousing a free market approach. Even among those who accept the legitimacy, or the political reality, of a market-based economy the paramountcy of various competing interests can still be a matter of debate. The adherents of public choice theory, for example, frequently start from the position that any government interference in the operation of the free market system is inherently illegitimate. The more extreme among such theorists dispute the need for any action by the state to redistribute resources in the interests of fairness or justness.

Theories of political liberalism, on the other hand, combine acceptance of market allocations and recognition of individual liberty with a concern that, to a greater or

153. These models represent the two extremes identified by commentators such as Ogus, supra note 1, chapter 1.
lesser extent, the state should intervene to alleviate unjust distributions of resources. At the other extreme, socialist or Marxist thought emphasises the pursuit of equality through state control of the means of production, distribution and exchange, to the total or partial exclusion of market processes. Under this approach, equality is conferred from the top down by removing advantages of personal privilege, wealth and power.

Given these divergences of approach to economic and social issues, it is largely meaningless to refer to the optimality of a regulatory decision without specifying the economic and political context in which the decision is to operate. Under each of the three models of political thought identified above, a different bundle of regulatory values will inevitably be present. Thus, a system favouring the interests of industry and the market economy will also be likely to prefer a regulatory regime with comparatively weak powers of intervention, so that regulated parties can pursue their business interests with a minimum of external government interference. It is therefore little surprise to find that in practice this tends to be the approach advocated by the New Right and by the adherents of public choice theory.

Liberal theorists are likely to recognise the need for some degree of regulatory intervention by the state in order to redress market failures, promote the interests of third parties such as consumers and to prevent unjust allocational outcomes. Socialist thinkers, on the other hand, will tend to favour the ultimate form of regulation, that of state ownership or control, or at the very least, close state involvement in the regulation of whatever market processes may be permitted to exist.


155. For contributions from this perspective see Crosland, The Future of Socialism (Cape, London, 1956); Habermas, Legitimation Crisis (trans. T McCarthy, Heinemann Educational, London, 1976); Pashukanis, General Theory of Marxism and Law (C Arthur (ed), London,
The approach taken in this thesis will be to assess techniques for regulatory improvement in terms of the market economy as it at present exists in Britain, without making any overt political judgments on the desirability or otherwise of the existing structure. Such an approach accepts the need to correct areas of market failure and other economic imperfections, as described in more detail in part 1.9 of this chapter, and also recognises the desirability of involving third parties such as consumers in the regulatory process in a more structured way. It is likely that external factors, such as the move to greater competition in many regulated areas of the UK economy, the influence of the move towards a single market among the EU member states together with the effect of EU developments generally and the present unlikelihood of a return to full scale nationalisation in the foreseeable future, will serve to influence the shape of regulatory intervention in the UK economy in the medium term.

156. See the discussion of this aspect in chapter 7.


158. One issue which arises here is of course the possible need to pay compensation in the event of significant British renationalisation. On this subject see the interesting analysis by Williams, "British Re-Nationalization and Regulation: The Government's Liability to Shareholders" (1993) 14 U Pa J Int Bus L 243. See also Ernst, supra note 56, p 82, where the author notes some of the possibly insurmountable practical difficulties confronting any attempt to renationalise the privatised industries. Labour Party policy prior to the 1997 General Election in relation to areas such as railways renationalisation was somewhat ambivalent. See for example article in The Times, 4 March 1996: "Opposition 'watering down' plans for railway buyback."
1.11  Methods of Regulation

1.11.1  Public v Private Ownership

Earlier in this chapter it was noted that public ownership and control, as in the case of nationalised industries, may be seen to represent the ultimate form of government regulation. Large scale nationalisation was adopted in the United Kingdom in the period after the war and prior to the privatisations of the 1980s and is also commonly encountered in collectivist economies. The UK experience with regulation through public ownership will be discussed in more detail in chapter 2.

So far as regulation of privately owned firms is concerned, various methods are in common use. A general distinction can be drawn between externally imposed regulatory methods and regimes of self-regulation, where the regulated entities have considerable input into the form of regulation imposed on them. In the UK context, self-regulatory methods are in evidence in areas such as the regulation of financial services and the press and in relation to individual professions, such as law, medicine and accountancy. Self regulatory techniques will be discussed further in subsequent chapters. The various methods of externally imposed regulation will now be outlined further.

1.11.2  Regulation Through Rate-Setting or Price Capping

This form of external regulation represents one of the most common regulatory methods, both in the United Kingdom and the United States. In the US context, the state public service commissions have exercised rate-setting powers over public utilities since very early in the present century. This function has not been uncontroversial, and some economists have argued that utility rate regulation has been largely counter productive and has often been sought by the utilities themselves

159.  For a general discussion of public ownership as a form of economic regulation see Ogus, supra note 1, chapter 13. For a discussion of legal and economic aspects of UK nationalisation see the texts referred to in notes 24, 60 and 83 supra.

160.  For a general discussion of the nature of self-regulation see Ogus, supra note 1, pp 107-111 and the discussion in part 4.7 of chapter 4.
as a means of discouraging market entry. In Britain, price capping formulas imposed by individual regulators have been an important aspect of the regulation of privatised natural monopolies, although the significance of this form of regulation may well decline as the industries in question are opened up to full competition over the next year or so.

1.11.3 Licensing/Franchising Arrangements

This regulatory method provides an alternative to rate setting or price control mechanisms and has been used in both the United Kingdom and the United States. In the United States, the use of such techniques has been both advocated and employed (to a lesser extent) in relation to public utilities and other forms of natural monopoly, where an operating franchise has sometimes been allocated to a company offering the most competitive pricing package. Under such a system competition between rival contenders for the franchise replaces external control by a regulatory commission. Franchising arrangements have also been implemented in the past in relation to industries such as cable television.

Regulation by licensing or franchising represents the chosen UK method in relation to the privatised rail industry, television broadcasting services and civil aviation route regulation, although the actual method of allocation varies in each of these cases, and

161. See for example Demsetz, "Why Regulate Utilities?" (1968) 11 J L & Econ 55, who asserts at p 65: "In the case of utility industries, resort to the rivalry of the market place would relieve companies of the discomforts of commission regulation. But it would also relieve them of the comfort of legally protected market areas. It is my belief that the rivalry of the open market place disciplines more effectively than do the regulatory processes of the commission. If the managements of utility companies doubt this belief, I suggest that they re-examine the history of their industry to discover just who it was that provided most of the force behind the regulatory movement."

162. For a discussion of the UK approach to regulation of natural monopoly through price capping see Foster, supra note 58, chapter 6 and the texts referred to in notes 54 and 55 above.

163. For a discussion of the use of franchising techniques of this kind in the United States see Demsetz, supra note 161, pp 63-64; Priest, "The Origins of Utility Regulation and the 'Theories of Regulation' Debate" (1993) 36 J L & Econ 289 at pp 299-301.

164. See Williamson, "Franchise Bidding for Natural Monopolies - In General and With Respect to CATV" (1976) 7 Bell J Econ 73; Veljanovski and Bishop, Choice by Cable - the Economics of a New Era in Television (IEA, London, 1983), chapters 6 and 7.
involves a fully-fledged public hearing in relation to air transport licences. In the case of the privatised utilities, this approach did not find favour at the time the utilities were originally privatised during the 1980s, given the need to retain the pre-existing industry structures, at least in the medium term. External regulation was therefore the approach adopted.

1.11.4 Regulation by Standard Setting

Regulation by standard setting has traditionally been an important component of US economic regulation and the rule making activities of the US regulatory agencies will be the subject of more extensive discussion in chapter 6.165 Agency rule making in the UK has been less pronounced, although some initiatives in this area have been undertaken in fields such as occupational health and safety.166 Techniques of this kind, which are sometimes described under the general heading of command and control regulation, have occasionally been criticised on the grounds that they lack efficiency compared to other methods, such as the securing of regulatory compliance through negotiation and bargaining.167

In the case of the privatised utilities, the regulators have issued periodic statements of policy. In the telecommunications field, the proposed OFTEL licence condition on anti-competitive behaviour incorporates various published guidelines relating to the exercise of the regulator's discretion in this area. While these are non-binding in the legal sense, they are to be adopted in their final form only after intensive industry and public consultation and exhibit many of the characteristics of standard setting or rule making which are familiar in US economic regulation.168

165. For a discussion of the use of rules and standards in US regulation see Mitnick, supra note 1, chapter 8; Friendly, supra note 45 and the texts referred to in note 44 supra.

166. For a discussion of these initiatives see Baldwin, Rules and Government, supra note 8, chapters 5-7.


168. For a discussion of the OFTEL initiatives see parts 9.6 and 9.7 of chapter 9.
1.11.5 Other Regulatory Methods

Various other methods of external regulation have been both suggested and attempted in the context of economic regulation in the United Kingdom and the United States. These methods include the use of marketable property rights, incentive-based regimes, which may involve taxes or subsidies, adjudication, bargaining and negotiated regulatory techniques, and a free market approach relying on general competition law. These techniques will be described more fully in chapter 3, dealing with differing methods of economic regulation, and in chapter 6, dealing with the US position. To date they have not been explored to any great extent in Britain, with a few exceptions, although there are periodic expressions of support for these "less restrictive" alternatives, as Breyer terms them, in both the US and UK literature.

1.12 The Influence of Administrative Law on Economic Regulation

In assessing the application of process-oriented techniques of economic regulation some consideration needs to be given to the role of administrative law in the area of economic regulation. There is a fundamental divergence in this area between the

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169. For a discussion of this technique see Ogus, supra note 1, pp 249 - 250; Mitnick, supra note 1, chapter 6.

170. See Ogus, supra note 1, pp 246-249; Mitnick, supra note 1, chapter 7.

171. On the use of adjudicative techniques in UK economic regulation see part 9.5 of chapter 9. For the US position see parts 6.4.2(i) and 6.4.2(ii) of chapter 6; Breyer and Stewart, supra note 40, pp 41-65 and chapter 6.

172. On the use of these techniques in UK economic regulation see part 4.4 of chapter 4. On the US position see part 6.6.3 of chapter 6 and part 10.3 of chapter 10.


174. See for example Breyer, supra note 68, chapter 8, who observes at p 156: "The next five alternatives - disclosure, taxes, marketable rights, disability rules, and bargaining - may be thought of as generally less restrictive ways of achieving regulation's ends." For some discussion of these alternative approaches to regulation in the UK literature see the excerpts from Ogus, supra note 1, referred to in notes 169-170 above; Baldwin and McCrudden, supra note 16, chapters 5, 11 and 12; Daintith, supra note 2, 539-540; Baldwin, Regulation in Question: The Growing Agenda, supra note 143, pp 26-32.
United Kingdom and the United States. US administrative law is closely bound up with the role of the independent regulatory agencies and their activities under the Administrative Procedure Act.

The standard US administrative law texts therefore cover matters such as the powers and duties of the administrative agencies, including their constitutional position in relation to delegations of legislative power, procedures under the US APA such as rule making and adjudication, hearing and due process requirements and the availability and scope of the remedy of judicial review in relation to agency decisions.\textsuperscript{175}

Decisions of US regulatory agencies can be reviewed by the courts not only on the basis of action taken outside the scope of the agency's legislative mandate but also for breach of the requirements of the US APA and of agency rules made under the APA. There are accordingly a number of ways in which agency action can be attacked by judicial review in the US courts. The US Supreme Court has recently affirmed that the power of review survives statutory attempts to preclude its exercise, as a matter of fundamental constitutional interpretation.\textsuperscript{176} The APA itself confers wide powers of review of agency action and the US courts have given these powers a broad reading.\textsuperscript{177}

A regulatory agency can therefore be reviewed in the US courts for not following the prescribed APA procedures in relation to rule making and adjudication. In addition, and often more significantly in practice, an agency can also be subject to judicial review for not following its own rules in the course of its regulatory activities.\textsuperscript{178} Requirements of standing to seek review have been progressively relaxed by the US

\begin{enumerate}
\item \textsuperscript{175} These topics are reflected in the table of contents of the leading US administrative law texts. The list in the text is based on the chapter headings in Schwartz, \textit{supra} note 39.
\item \textsuperscript{176} \textit{Webster v Doe} 486 US 592 (1988).
\item \textsuperscript{177} See the discussion in part 6.5.3 of chapter 6; \textit{Abbott Laboratories v Gardner} 387 US 136, 140-141 (1967).
\item \textsuperscript{178} In practice an agency's non-compliance with its own adopted rules forms the basis for a high proportion of judicial review proceedings in the US federal courts. See the discussion in part 10.7 of chapter 10, concerning FCC regulatory practice.
\end{enumerate}
courts in recent years\textsuperscript{179} and while the power of review is limited to the material contained in the agency record the reviewing court can enquire into whether the agency decision on the facts is supported by "substantial evidence".\textsuperscript{180}

On review the court will examine the reasonableness of the agency decision in question in the light of the whole of the agency record and will "give effect to a reasonable agency interpretation of a statute unless that interpretation is inconsistent with a clearly expressed congressional intent."\textsuperscript{181} Under this "Chevron" approach the reviewing court will seek to accord reasonable deference to an agency decision that is not clearly perverse or unreasonable.

The contrast with UK administrative law is marked. Courts in Britain have no written constitution or APA-type statute against which the legality of an administrative decision can be assessed. Judicial review is limited to certain defined grounds, such as procedural impropriety, irrationality, illegality and (perhaps) lack of proportionality.

In the absence of a statutory right to review agency decisions the question of what constitutes a public body for the purposes of judicial review remains a live issue in Britain, although the modern approach to this issue, which focuses on the type of function performed by the decision-making body rather than the nature of the powers granted to it, is proving to be more flexible in practice.\textsuperscript{182} By focusing on such a test the UK courts have seen their way clear to extending the remedy of judicial review to the activities of privatised bodies in various areas.

\textsuperscript{179} See Schwartz, \textit{supra} note 39, pp 495-518, which discusses the recent case law in this area. Parties such as competitors of a regulated firm, consumers of services the price of which has been affected by a regulatory decision and citizens' groups which can demonstrate an organised interest in areas such as environmental protection, have been accorded standing to seek judicial review.

\textsuperscript{180} The nature of this power is discussed in Schwartz, \textit{supra} note 39, pp 632-644.


\textsuperscript{182} See the discussion in de Smith, Woolf and Jowell, \textit{supra} note 11, pp 167-168 and in part 8.3.4(ii) of chapter 8.
The UK courts have displayed varying degrees of deference to regulatory decisions in the past, although recent indications from the higher appellate courts are that they will be reluctant to interfere with the decisions of regulatory bodies operating in their particular area of expertise in the absence of compelling circumstances.\footnote{183} To this extent UK and US practice in relation to judicial deference to agency decisions appears to be similar, despite the other wide disparities in the approach to judicial review in the two jurisdictions. There are other areas in which contemporary UK administrative law has demonstrated a capacity for innovation. The application of concepts of fundamental rights and of the evolving doctrine of legitimate expectation to the development of consultation and participation requirements in the regulatory area, for example, are aspects that will be discussed in more detail in chapter 8.\footnote{184}

One of the primary tasks of this thesis will be to identify the ways in which administrative law remedies can underpin the use of new techniques in economic regulation and what changes in approach in this area would further the objective of improved economic regulation in Britain. This task will be addressed in more detail in the course of the following chapters.

\footnote{183. See for example the discussion in part 8.3.5(ii) of chapter 8, concerning recent attempts to obtain judicial review of licence allocation decisions by the Independent Television Commission.}

\footnote{184. See the discussion in parts 8.2.2(iii), and 8.4.2 to 8.4.4 of chapter 8.}
2. THE EVOLUTION OF REGULATORY REGIMES: SOME LESSONS FROM HISTORY

2.1 The Relevance of Historical Experience

A study of the historical evolution of economic regulation in both the United Kingdom and the United States serves to shed some light on the development of modern regulatory regimes and the factors influencing the design of regulatory rules. State regulation, initially through primary and later delegated legislation, has long been a feature of common law jurisdictions. Early attempts to control market practices and concentrations of monopoly power arose more from fear of the consequences of failing to do so, in terms of the possibility of outbreaks of dissent among the populace, than from more modern concerns with the effect of these practices on individual welfare. The need to preserve political power, though nowadays more refined in terms of its theoretical sophistication, has always been of great significance as one of the primary motivating factors in the regulatory context.

More modern attempts to regulate in the economic area, such as in relation to public utilities, owe much to early common law doctrines. Certain basic requirements, such as the obligation to provide universal service without discrimination and at a reasonable price, were developed first by the common law courts and, at a much later stage, came to be embodied in legislation. The significance of early concepts of the corporate entity, which envisaged accompanying social obligations, will also be considered in this chapter. It is difficult to understand fully the nature of modern regulatory regimes in these areas without some appreciation of their historical origins. Without necessarily having to agree with George Santayana's observation that those who cannot remember the past are condemned to repeat it, it can certainly be said here that ignorance of the history of regulation may well lead to perplexity concerning some of its present nuances.

The regulatory institutions developed in Britain during the Victorian era also merit some examination. During an age of ostensible laissez faire the state actually developed a range of regulatory techniques and institutions in various areas of social and economic regulation, ranging from the administration of the poor law through commissioners to regulatory activity in relation to railways, water and gas. Concerns about the efficiency and accountability of such institutions also began to surface during this period, and some early attempts were made to relate administrative action of this kind to existing theories of the political and constitutional nature of the British state. These developments in Britain were mirrored in America by the growth of US regulatory institutions, beginning with the Interstate Commerce Commission in 1887, a process which will be addressed in more detail in chapter 6.

The present chapter goes on to analyse some of the implications of state control through the nationalisation of major UK industries in the post war period, including the theoretical origins of the public corporation and concerns about efficiency, openness of decision making, accountability and lack of attention to consumer interests. Finally the move towards privatisation during the 1980s is considered, together with the economic and political background to this development and some of the regulatory issues arising from privatised ownership.

2.2 Early English Regulation - The Tudor and Stuart Periods and the Rise of Delegated Legislation

2.2.1 Legislative Regulation

It is appropriate to begin an examination of the history of government regulation in England with the Tudor and Stuart periods, which in many ways represent a high water mark in the era of government regulation in the economic sphere, as Ogus has rightly observed.²

² Ogus, "Regulatory law: some lessons from the past", (1992) 1 Legal Studies 1 at 17. See also Ogus, Regulation - Legal Form and Economic Theory (Clarendon Press, Oxford, 1994) at pp 6-7: "At no time in English legal history has the law governing industry and commerce been so extensively and intensively penetrated by regulation as in the Tudor and Stuart periods. A study of these early regulatory systems can surely contribute to our understanding of the nature and
The Tudor and Stuart eras witnessed a period of intense government intervention in the
economic affairs of England. Over this period several hundred statutes of a regulatory
nature were enacted, coupled with a number of royal proclamations and similar
instruments. This was an age in which the monarchy held strong central power, with
tendencies towards absolutism in certain cases, and the constitutional influence of
Parliament was only beginning to make itself felt. It was also a period in which foreign
powers exerted both a real and potential threat to the realm, as the then recent
experience of the Spanish armada and the territorial ambitions of Philip II of Spain had
amply demonstrated.

The spectre of internal dissension, ranging from localised discontent to the possibility
of large scale uprising, was an ever present one, and concern over such a situation,
rather than any paternalistic reasons, motivated much interventionist regulation during
this period. At a time when notions of individual freedom and liberty were very much
in their infancy, where they existed at all, regulatory legislation served the purpose of a
safety valve, relieving the pressure of popular discontent, rather than being primarily
aimed at improving the lot of the citizenry. This was particularly so in areas such as
price and quality control, restraints on undesirable market practices and legislation
relating to agrarian matters such as the enclosure system, much of which was directly
concerned with addressing potential sources of internal dissension.

Finer traces the rise of state control and regulation as part of an increasing progression
from the Middle Ages to Victorian times, with Adam Smith's landmark work *The
Wealth of Nations*, published in 1776, representing one of the only significant

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3. For early examples of price-fixing statutes see 4 Edw III, c 12 (1330); 23 Edw III, c 6 (1349);
   25 Hen VIII, c 2 (1533). For a history of price controls on corn supplies in Tudor times see
   University, Cambridge, Mass., 1915).

4. For a discussion of the legislative provisions concerning enclosures during this period see
   Thirsk, "Enclosing and Engrossing" in Finberg, *The Agrarian History of England and Wales*

5. For a general discussion of these regulatory initiatives see Jones, "Historical Development of the
   Law of Business Competition (Part 1)" (1926) 35 Yale LJ 905 at 906-917.
intellectual queries of this process during that period, at least in the economic sphere.\(^6\) In the area of trade, the period witnessed the introduction of projectionist legislation, particularly in relation to restrictions on the importation of cloth and textiles and also prohibitions on the export of wool and unfinished cloth.\(^7\)

Such measures, then as now, proved to be controversial in both political and economic terms. Protectionist laws, in particular, attracted criticism from the classical economists. Adam Smith, for example, trenchantly criticised laws of this kind.\(^8\)

Regulation by legislative fiat could be very much a blunt instrument and modern conceptions of the optimal regulatory regime, as outlined in chapter 1, have limited relevance when applied to the social and political conditions of that era. Nevertheless the experience with the use of legislation as the primary means of economic regulation during this period of English history reveals a strong political awareness of the need to control undesirable market practices and the consequences of unchecked monopoly power. In our own time, when revolutions are more bloodless in nature, these essential concerns still remain.

2.2.2 The Rise of Delegated Legislation

It is also instructive in the context of an historical survey to trace the broad outlines of how the use of delegated legislative power developed in Britain as this sheds some light on the present use of such techniques in the regulatory area. As with many legal concepts, delegated legislation has been a feature of the English legal system dating back at least to Tudor times,\(^9\) with early examples being provided by the delegated

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7. For a summary of the scope of these areas of regulation see Ogus, "Regulatory law: some lessons from the past", supra note 2 at pp 5-11.
8. Smith, The Wealth of Nations (Cannan (ed), Univ of Chicago Press 1976, 1st edn published 1776), Book IV, page 165, "...which the clamour of our merchants and manufacturers have extorted from the legislature, for the support of their absurd and oppressive monopolies."
powers contained in the Statute of Sewers 1531 and the Statute of Proclamations 1539. The law of 1531 gave considerable law making power to the Commissioners of Sewers. Later, in 1539, the Statute of Proclamations gave Henry VIII wide powers to legislate by proclamation, helping in no small measure to promote his subsequent historical reputation for possessing some of the attributes of an absolute ruler.

The 17th century witnessed a continuing struggle between the King and Parliament, with the eventual ascendancy of the latter, although only after one monarch had lost his head and another had been forced to flee the realm. The supremacy of Parliament as a law making body was asserted early in that century by Chief Justice Coke in 1611 in the Case of Proclamations, although Coke's subsequent dismissal from office by James I a few years later illustrates that the independence of the judiciary remained a fragile concept at that time.

The distinction between primary and delegated legislation inevitably became blurred during Cromwell's interregnum when law making was carried on by ordinance. After the Restoration, constitutional attention focused on the asserted claims of the Crown to dispense with or suspend legislation. Matters came to a head in the Seven Bishops Case in 1688, when seven of the bishops were tried for seditious libel for speaking out against their assigned role in distributing indulgences. The Solicitor-General's prosecution, coming before an unsympathetic Lord Chief Justice Wright and three other judges, was soon enmeshed in a number of technicalities concerning the legality of the Declarations of Indulgence of 1687 and 1688. These included the use of the royal prerogative to issue them and the legality of the Order-in-Council requiring the

10. (1611) 12 Co Rep 74; 77 ER 1352. For an interesting discussion of some of these developments and the role of Chief Justice Coke in promoting them see Galligan, Due Process and Fair Procedures (Clarendon Press, Oxford, 1996), chapter 2, entitled "Procedural Fairness in the English Common Law".

11. See for example Thomas v Sorrell (1674) Vaugh 330; 124 ER 1098.

12. (1688) 12 St Tr 416.

13. See The Proceedings and Tryal in the Case of the Most Reverend Father in God William, Lord Archbishop of Canterbury, and the Other Bishops, (anonymously written), (London, 1689) at p 431 where, after the jury had acquitted the bishops (to tumultuous applause from the public gallery), Lord Chief Justice Wright stated: "I am as glad as you can be that my Lords the Bishops are acquitted; but your manner of rejoicing here in Court is indecent; you might rejoice in your chambers, or elsewhere, and not here." (The writer obtained a copy of this delightful book from an antiquarian bookshop in Charing Cross Road, London.)
bishops to distribute them in the face of Parliamentary opposition to the Order. This case provides one of the earliest examples of a successful challenge to the validity of delegated legislation in the courts, and one which was to have many later precedents.

In the end the Bishops' stance was vindicated when the Bill of Rights of 1689 abolished any rights on the part of the sovereign to issue instruments of this kind. The Act of Settlement which followed in 1700 was a further step in the process of establishing Parliament as the supreme law making body. These early developments helped to breed an awareness of the need for judicial supervision of the instruments of delegated legislation, a matter which is now of considerable significance in the regulatory area, both in Britain and America.

2.3 The Development of the Concept of Monopoly

2.3.1 Early Experience with Monopolies

Much economic regulation in modern times has been concerned with attempts to control the exercise of various forms of monopoly power. It is therefore instructive to consider how monopolies came to be regulated originally. The economic concept of monopoly is one which has an ancient, if not exactly respectable, pedigree. Historians have identified references to monopolistic practices as early as 2100 BC in the

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14. For an account of the vicissitudes of the Solicitor-General in endeavouring to prove the due execution under the Great Seal and the proper issuance of the Declaration of Indulgence of 4 April 1687 through some obviously reluctant witnesses see the account of the trial, supra note 13, at pp 146-176. A sample, from pp 175-176, of the rather entertaining examination in chief by the Solicitor-General of one Nathaniel Powell, clerk to the Bishop of Chichester, is as follows:

"Mr Sol.Gen.: Do you know his handwriting?
Powell: Yes, I believe I do.
Mr Sol.Gen.: Look upon that name of his.
Powell: I did not see my Lord write that.
Mr Sol.Gen.: Who says you did? Nobody asks that of you; how you answer; Pray Sir, remember your Oath, and answer seriously. Do you believe it to be his writing or no?
Powell: I believe it is like my Lord's handwriting, but I did never see him write it.
Mr Sol.Gen.: Nobody says you did.
Powell: Therefore I cannot swear positively it is his hand...
Mr Sol.Gen.: (following several other inconclusive exchanges): My Lord, if these things be endur'd, there will be an end of all testimony, if witnesses do not answer fairly to the questions that are asked them."
Babylonian Code of Hammurabi and the existence of monopolies in certain markets was recognised in both Greek and Roman times.\textsuperscript{15}

In English experience, the development of the concept of monopoly is closely related to the evolution of the privileged position of the merchant and craft guilds after the Norman Conquest. As early as 1266 a statute of Henry III made criminal market practices such as forestalling (cornering the market in a particular commodity by buying it up prior to the opening of the organised market) and engrossing (the hoarding of large quantities of a product to sell later when supply was short).\textsuperscript{16} Sir Thomas More, in his \textit{Utopia}, introduced the term "monopoly" to the language in 1515 in a thinly disguised allegory condemning such practices in England by reference to the experiences of the mythical Utopians.\textsuperscript{17}

It was not long before the Crown recognised the revenue-raising potential of monopolies, in the sense of a Crown grant of the exclusive right to manufacture or sell certain items. During the reign of Elizabeth I a number of monopolies of this kind were granted, especially from about 1560 onwards. As legal historians such as Holdsworth have pointed out, some of these were issued by way of royal patents, instruments which

\begin{itemize}
  \item \textsuperscript{15} Aristotle in \textit{The Politics} (Rackham translation, William Heinemann Ltd, London, 1932), at pp 55-56, mentions the practice of cornering the market in olive oil presses and iron by the buying up and hoarding of these commodities and the later reselling of them at great profit when demand had increased: "...καθαρσίν τοῦ τοιούτου χρηματιστικοῦ εἰς τὶς δυνατις μονοπώλιαν αὐτο κατασκευαζέων... (this device of taking an opportunity to secure a monopoly is a universal principle of business)." The \textit{Code of Justinian} in 533 AD, one of the great achievements of the later Roman emperors, contains explicit prohibitions on monopolistic practices. For a discussion of these early examples of monopoly see Machlup, \textit{The Political Economy of Monopoly - Business, Labor and Government Policies} (The Johns Hopkins Press, Baltimore, 1952) at pp 182-193.

  \item \textsuperscript{16} See 51 Hen III, c 6 (1266), followed in succeeding reigns by the statutes of 34 Edw I, c 5 (1306); 25 Edw III, stat 4, c 3 (1350); 27 Edw III, stat 2, c 11 (1353). For a general description of these early legislative attempts at regulation see Jones, \textit{supra} note 5.

  \item \textsuperscript{17} See More, \textit{Utopia} (ed Surtz, Yale UP, Newhaven and London, 1964, first published 1515), p 26, on the practice among the richer inhabitants of Utopia of cornering the market in wool and livestock: "Thus the unscrupulous greed of a few is ruining the very thing by virtue of which your island was once counted fortunate in the extreme...".
\end{itemize}
differed from medieval grants of special privilege to promoters of new industries in that they created a right of monopoly.\(^\text{18}\)

The grant of monopoly rights to private individuals at their own instigation, or in reward for services to the sovereign, led inevitably to abuse in some cases, as has been noted by Holdsworth and others.\(^\text{19}\) Queen Elizabeth I barely managed to retain her prerogative power to grant patents, a practice which came under greater pressure in the closing years of her reign. That she was able to do so was an achievement which Holdsworth regards as one of her greatest diplomatic triumphs.\(^\text{20}\)

However, the validity of grants of monopoly by royal patent did later attract the scrutiny of the court in *The Case of Monopolies*.\(^\text{21}\) One Darcy, a groom of the Queen's Privy Chamber, had been granted a sole patent for the importation and selling of playing cards by the Queen in 1588. His patent was allegedly infringed by a London haberdasher, a Mr Allein, and Darcy brought an action against Allein in respect of this infringement. The judges held after argument that the monopoly granted to Darcy was illegal, being contrary to the common law, statute and the liberty of the subject. It is illuminating to examine the reasoning of the court in this case as it represents the first comprehensive judicial analysis in England of the monopoly concept.

It was held that Darcy's patent was illegal at common law for several reasons. First, any monopoly grant of rights in trade restricted the possibility of employment and increased the possibility of idleness. The court went on to point out that the monopoly

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19. See Holdsworth, *ibid* p 347, who notes: "Of the magnitude of the evils caused by these inconsiderate grants to all classes of the community there can be no question. Hindrance to trade and manufacture, high prices, inferior goods, and all kinds of oppression were the natural consequences. And while court favourites were rewarded by patents which enabled them to control the manufacture of or the trade in the common necessaries of life, really meritorious inventors were unable to obtain protection." For useful summaries of the granting of monopoly rights by royal patent during the reign of Queen Elizabeth I, see Jones, *supra* note 5, at pp 930-933; Letwin, *Law and Economic Policy in America* (Edinburgh UP, Edinburgh, 1966), pp 22-32.


21. (1602) 11 Co Rep 84 b; 77 ER 1260; also reported as *Darcy v Allein* (1602) Moore KB 671; 72 ER 830. For a discussion of the early English cases on monopolies see Letwin, *supra* note 19, chapter 2.
right would lead to an increase in prices\textsuperscript{22} and that the grant of a monopoly right could lead to deliberate restrictions on the supply of the commodity.\textsuperscript{23} It observed that a monopoly right served to restrict employment on the part of those who had previously manufactured the article in question\textsuperscript{24} and that even though the royal grant of the patent of monopoly was intended to be for the general good, it in fact prejudiced the public interest by promoting the private gain of the monopolist.\textsuperscript{25}

For good measure the court went on to observe that "playing at cards is a vanity, it is true, if it is abused, but the making of them is neither a vanity nor a pleasure, but labour and pains."\textsuperscript{26} It also asserted that the grant of the monopoly to Darcy was contrary to statute, as representing an encroachment on freedom of trade and traffic, and was therefore also void on that account.

This interventionist approach on the part of the judges was followed by Chief Justice Coke several years later in the \textit{Case of the Tailors of Ipswich}\textsuperscript{27} in 1615, in which the court held that a guild or corporation incorporated under royal charter could not restrain an unqualified person from working at the trade as this would encourage idleness and

\begin{itemize}
  \item \textsuperscript{22} "...the price of the same commodity will be raised, for he who has the sole selling of any commodity, may and will make the price as he pleases...": (1602) 11 Co Rep 84b at 86b; 77 ER 1260 at 1263.
  \item \textsuperscript{23} "...after the monopoly [is] granted, the commodity is not so good and merchantable as it was before: for the patentee having the sole trade, regards only his private benefit, and not the common wealth."; (1602) 11 Co Rep 84b at 86b; 77 ER 1260 at 1263.
  \item \textsuperscript{24} "It tends to the impoverishment of divers artificers and others, who before, by the labour of their hands in their art or trade, had maintained themselves and their families, and who now will of necessity be constrained to live in idleness and beggary...you shall not take in pledge the nether and upper millstone, for that is his life; by which it appears, that every man's trade maintains his life, and therefore he ought not to be deprived or dispossessed of it, no more than of his life...": (1602) 11 Co Rep 84b at 86b-87a; 77 ER 1260 at 1263.
  \item \textsuperscript{25} This strategy, by which the court sought to circumvent the grant of the monopoly patent by referring to its express terms and then comparing those terms with the opposite economic effect engendered by the patent, can be regarded as a clever device which allowed the court to strike down the patent while still preserving a measure of face-saving from the perspective of relations with the sovereign. This was a strategy which may have had some personal appeal to the judges at a time when their position in relation to the state was less firmly entrenched than it later became!
  \item \textsuperscript{26} (1602) 11 Co Rep 84b at 87a; 77 ER 1260 at 1264.
  \item \textsuperscript{27} (1615) 11 Co Rep 53a; 77 ER 1218.
\end{itemize}
lack of employment. The motivation of the judges may not have been entirely libertarian in these cases, as Harding, for example, has argued.28

Furthermore, as Holdsworth again has noted, the concept of freedom of trade did not have the same meaning for Coke and his fellow judges as the economic and political connotations which the term bears in its current usage. The judges in Coke's time were referring to freedom from arbitrary sovereign action unrestrained by Parliament, and not to individual freedom of action where this was contrary to the legitimate interests of the state. For example, a grant of monopoly rights to the inventor of a new process might well be justifiable, as opposed to the grant of a privileged monopoly to a favoured courtier, as in Darcy.29

Abuse of monopoly patent rights continued to occur during the reign of James I, who in times of fiscal expediency was not above resorting to the illegal grant of monopoly patents as a means of raising revenue for the purposes of the Crown.30 This represented one of the many sources of friction, if not outright conflict, between Chief Justice Coke and the King, a conflict which led to Bacon's famous warning to the judges that they should not seek to usurp the legislative function.31

Parliament sought to counter these abuses, and in 1624 it passed an Act prohibiting royal grants of monopoly, under which patents of monopoly were to be restricted to new inventions and for terms of 14 years. Coke's part in the passing of this legislation was significant. He had been one of the original drafters of the bill (which had

28. Harding, A Social History of English Law (Penguin Books, London, 1966) at p 223: "Coke shows a consistent bias against the regulation of trade, perhaps because he feared the royal prerogative which was the instrument of this regulation, but also because he was a member of a class which was grasping the opportunities of untrammelled economic enterprise."

29. Holdsworth, supra note 18, pp 350-351.

30. Holdsworth, supra note 18, p 353.

31. Bacon's Essays: "Of Judicature" (Henry Bohn & Co, London, 1852, first published 1612), pp 149-150: "Let judges also remember that Solomon's throne was supported by lions on both sides: let them be lions, but yet lions under the throne; being circumspect that they do not check or oppose any points of sovereignty."
originally been rejected by the House of Lords in 1621) and if he was not the author of the final version he certainly played a pre-eminent role in its final form.\footnote{For discussions of the background to this legislation and Coke's part in its enactment see Bowen, \textit{The Lion and The Throne - The Life and Times of Sir Edward Coke 1552-1634} (Hamish Hamilton, London, 1957), pp 380-382; Kerridge, "Early Modern English Markets" in Anderson and Latham (eds), \textit{The Market in History} (Croom Helm, London 1986), at pp 139-141.}

This two-pronged attack by both Parliament and the judiciary on monopoly rights led to the decline of the power of the guild system and also to the eventual ending of royal monopoly grants altogether, a process which did not finally occur until after the Glorious Revolution towards the end of the 17th century. Another important factor was the evolution of the doctrine of restraint of trade at common law, which also developed over this period.\footnote{For a discussion of these historical trends see Heydon, "Restrictive Trade Practices and Unfair Competition" in Kamenka and Tay (eds), \textit{Law and Social Control} (Edward Arnold, London, 1980), pp 133-146. The courts gave great impetus to the doctrine of restraint of trade after the important case of \textit{Mitchel v Reynolds} (1711) 1 P Wms 181; 24 ER 347 drew the fundamental distinction in terms of enforceability between reasonable and unreasonable covenants in restraint of trade.}

Similar sentiments were conveyed to the New World and statutory provisions prohibiting or controlling monopolistic practices were soon to be found in America among the early legislative enactments of the colonies of Virginia and Massachusetts.\footnote{For a summary of these early legislative provisions see Editorial Note, "State Regulation of Prices Under the Fourteenth Amendment" (1919) 33 Harv LR 838 at 838-839; Jones, "Historical Development of the Law of Business Competition (Part 2)" (1926) 36 Yale LJ 42.}

\subsection*{2.3.2 Variations in Judicial Attitudes}

Some relaxation in the judicial attitude to monopolies was evident in certain areas. One of the principal examples was the judicial indulgence shown towards the chartered trading companies, such as the East India Company, which had rights granted by patent for the sole trade in certain areas such as the East Indies. These rights in respect of foreign trade, despite being essentially monopolistic in nature, survived legal challenges largely unscathed. In the case of the East India Company, the Court of Kings Bench upheld that company's trading monopoly in a case decided in 1683.\footnote{\textit{The Great Case of Monopolies: Sandys v The East India Company} (1683) 10 St Tr 371.}
dismissing a challenge by a potential competitor to the company's trade monopoly in the East Indies. Chief Justice Jefferies observed in his judgment that charters granting exclusive trading rights fell outside the statutory prohibitions on monopoly power.\(^{36}\)

The court was also influenced by the longstanding nature of the company's privilege and the fact that the company had taken the risk of developing its East Indies trade at great expense so that "it would be against natural justice and equity (which no municipal law can take away) for others to reap the benefit and advantage of all this".\(^{37}\) In the final event the East India Company's monopolistic trading privileges lasted for more than another one hundred years until they were finally abolished in 1813. (It is no doubt illustrative of the different mood of the 19th century that guilds were similarly abolished by Parliament in the following year, 1814.)

Throughout the 18th century, English legal thinkers displayed a persistent reluctance to condemn anti-competitive practices which might on balance operate in the public interest. Blackstone, for example, expressed the view that local businesses such as mills, bake houses and malt houses were erected for the convenience of local inhabitants to be used as the exclusive place for such activities, thereby avoiding wasteful duplication of local resources.\(^{38}\) For over a century, the English courts were prepared to allow the owners of mills and similar local businesses to bring actions to prevent the establishment of competitive undertakings in a particular local area, and

\(^{36}\) Ibid at 538: "And therefore I proceed to the next step, that although unlawful engrossing, and monopolies are prohibited by the laws of this, and all other nations; yet I do conceive, that the charter now in question, of a sole trade exclusive of others, is no such unlawful engrossing, or monopoly but is supported and encouraged as conducing to public benefit by the law, practice, and usage of this and other countries. And herein, either way, though the word Monopoly, or Engrossing, generally spoken of is odious in the eye of our law, yet some engrossing, and so some monopolies, are allowed of in our books...".

\(^{37}\) Ibid at 552-553.

\(^{38}\) Blackstone, *Commentaries on the Laws of England* (Clarendon Press, Oxford, 4th ed, 1770), Book III, p 235 (on the desirability of making exclusive use of local mills): "There are also other services, due by ancient custom and prescription only. Such is that of doing suit to another's mill; where the persons, resident in a particular place, by usage time out of mind have been accustomed to grind their corn at a certain mill; and afterwards any of them go to another mill, and withdraw their suit, ... from the ancient mill. This is not only a damage, but an injury, to the owner; because this prescription might have a very reasonable foundation; viz upon the erection of such mill by the ancestors of the owner for the convenience of the inhabitants, on condition, that, when erected they should all grind their corn there only."
even to destroy those which had been established.\textsuperscript{39} It was not until 1823 that the English courts reconsidered the earlier authorities.\textsuperscript{40}

The cases on judicial treatment of monopolies continued up to and during the 19th century, with the courts often adopting a restrained approach to commercial dealings, even where on their face they might be prejudicial to the public interest. As Simpson has noted in the course of his review of the 19th century monopoly cases, one of the failings of the common law approach was its evident inability to distinguish between cases involving different degrees of harm to the public interest.\textsuperscript{41} Indeed, during the 19th and early 20th centuries, examples can be found of cases where the courts were reluctant to suppress monopolistic practices for fear of the consequences which might arise from ruinous competition.\textsuperscript{42}

The cases on the control of monopoly power over this period demonstrate a diversity of judicial attitudes, ranging from grudging support to outright hostility, although monopolies in more strategic areas, such as the trading interests of the realm, were generally treated with greater circumspection. Such a divergence in judicial approach has continued to the present day, with some courts treating agency decisions in the area

\textsuperscript{39} See for example Drake v Wigglesworth (1752) Willes 654, 125 ER 1369; Cort v Birbeck (1779) 1 Doug 218, 99 ER 143; Duke of Norfolk v Myers (1819) 4 Madd 83, 112, 56 ER 639, 650.

\textsuperscript{40} See Richardson v Walker (1823) 2 B & C 827, 839; 107 ER 590, 594, where the court referred to "... the increase of population and the alteration of manners [that] would make the mischief of such a restriction in these times incalculable."

\textsuperscript{41} Simpson, "How Far Does the Law of England Forbid Monopoly?", (1925) 41 LQR 393 at 394: "Unfortunately, combine or monopoly cases have been ranked with sales of goodwill. The reason is that the parties to a combine are commercial firms presumed to be capable of looking after themselves and not starving apprentices. This view overlooks the interests of the public. In combine cases the parties may be on velvet while the public is looted. In goodwill cases the public is only faintly stirred by the spectacle of the retired grocer trying to break his bargain. Yet the distinction has never been effectively drawn." For examples of a comparatively tolerant judicial approach in this area see Mogul Steamship Company v McGregor, Gow & Co. [1892] AC 25; Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd [1894] AC 535.

\textsuperscript{42} See for example Hearn v Griffin (1815) 2 Chitty 407, in which Lord Ellenborough CJ upheld the validity of a price-fixing agreement, describing it as being "merely a convenient mode of arranging two concerns which might otherwise ruin each other"; North-Western Salt Co. v Electrolytic Alkali Ltd [1914] AC 467 at 469 in which Viscount Haldane L.C. expressed the view that it was not in the interests of the public to allow excessive competition to "drive manufacturers out of business, or lower wages and so cause unemployment and labour disturbance"; Palmolive Co. v Freedman [1928] 1 Ch 264, in which Laurence LJ considered (perhaps somewhat optimistically) that it should not necessarily be assumed that a seller in a dominant market position would fix unreasonable prices.
of economic regulation with great deference and others exhibiting a more interventionist approach, as will be seen in later chapters.

2.4 Historical Evolution of Public Utility Services

2.4.1 The Concept of a Business Affected With the Public Interest

It is useful to consider at this stage the historical background to the evolution of public utility services as this serves to throw some light on the basis for regulatory intervention in their activities.

The utility company is a comparatively recent phenomenon which really only developed in its recognisable contemporary form over the course of the last century, in conjunction with the evolution of the modern city and its associated services. The supply of piped gas and water, and later in the 19th century the public reticulation of electricity, followed later by the growth of domestic telephone services, led to corresponding regulatory development in the utility area. However, the conceptual origins of utility services predate the provision of those services in their modern form.

As was noted above, monopoly privileges originated at a much earlier stage in English history and achieved prominence during the Tudor and Stuart periods. They arose in the context of the guilds, of patent rights for individual inventors and in relation to the foreign trading concessions granted to the early chartered companies such as the East India Company. At common law certain essential occupations and callings were also identified and made the subject of special obligations.

Thus, at a comparatively early stage in English legal history, ferry proprietors were permitted monopoly rights in respect of their particular routes, subject to controls by the courts over the reasonableness of their toll charges, in return for an obligation to provide an adequate and seaworthy service.43

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43. See Storey, "Origin and Monopoly Rights of Ancient Ferries" (1914-15) 63 U Pa LR 718 at 729: "The public aid is also shown in the fact that the English courts always construed the ancient ferry franchise to be an exclusive monopoly. This is interesting in view of the well settled rule that all grants from the Crown are construed strongly against the grantee. The basic reason for this ruling is found in the utilitarian policy that what is best for the greatest number. In 1444 Chief Justice Newton gave as the reason for this protection that the ferry man was
The courts gave a specific remedy to a ferryman, allowing protection against competition. This was conferred initially by way of an action upon the case and later in equity, or at the instigation of the Crown, on the basis of the prerogative writ of *quo warranto*.\(^{44}\)

Sir Matthew Hale, in his influential treatise *De Portibus Maris*, published posthumously by Hargrave in 1787 over a century after Hale's death in 1676, drew attention to the public interest element which he considered affected certain occupations, such as the proprietors of public wharves, operators of crane services and similar persons.\(^{45}\) The list of public occupations was gradually expanded and eventually included bakers, brewers, cab drivers, carriers, inn keepers, millers, blacksmiths, surgeons and tailors as well as the traditional categories of ferrymen and wharfingers.\(^{46}\) Even before this time the English courts had begun to recognise the element of public service implicit in a number of these occupations.\(^{47}\) In the case of

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\(^{44}\) For examples of these different procedures see *Blissett v Hart* (1744) Willes 508, 125 ER 1293; *Churchman v Tunstall* (1659) Hardr 162, 45 ER 432; *Cory v Yarmouth and Norwich Ry Co.* (1844) 3 Hare 593, 67 ER 516.

\(^{45}\) Hale referred to the fact that even though the wharf or crane might be established as a private business, such facilities nevertheless effectively enjoyed monopoly rights simply because there might be no other licensed wharf in the vicinity. In such cases the law imposed an obligation on the proprietor to only charge at a moderate rate. As Hale put it: "...the duties must be reasonable and moderate, though settled by the King's licence or charter. For now the wharf and crane and other conveniences are affected with a public interest and they cease to be juris privati only; as if a man set out a street in new building on his own land, it is now no longer bare private interest, but is affected by a public interest." (See Hargrave, *Collection of Tracts relative to the Law of England* (1787) at 77.) See also on this topic de Smith, Woolf and Jowell, *Judicial Review of Administrative Action* (Sweet & Maxwell, London, 5th ed, 1995), para 3-011. For recent discussions of the life and work of Sir Matthew Hale see D Yale, *Hale as a legal historian. Selden Society lecture delivered in the Old Hall of Lincoln's Inn, 7 July 1976* (Selden Society, London, 1976); Cromartie, *Sir Matthew Hale 1609-1676: Law, religion and natural philosophy* (Cambridge Studies in Early Modern British History, Cambridge UP, Cambridge, 1995).

\(^{46}\) For a general discussion of these developments in both the English and United States contexts see Phillips, *The Regulation of Public Utilities - Theory and Practice* (Public Utilities Reports Inc, Arlington, 1984) at pp 75-84. The excerpt from Sir Matthew Hale's work which is quoted in note 45, *supra*, was cited with approval by the Supreme Court of the United States in the leading case of *Munn v Illinois* 94 US 113 at 131-132 (1877) by Chief Justice Waite.

\(^{47}\) See for example *Rich v Kneeland* (1613) Cro Jac 330, 79 ER 282; *Jackson v Rogers* (1683) 2 Show 327, 89 ER 968; *Lane v Cotton* (1701) 1 Ld Raym 646 at 654; 91 ER 1332 at 1336: "If a man takes upon him a public employment, he is bound to serve the public as far as the
ferries, such recognition extended back as far as the fifteenth century.\textsuperscript{48} The use of the term "common" in this context referred to an occupation with a public element, in the sense that those carrying it on were not only available to serve the public generally but were also subject to a certain degree of state control. A recent study by Craig in this area has noted the evolution of common callings and their relationship to the exercise of monopoly power.\textsuperscript{49}

Hale's principle of "business affected with a public interest" proved remarkably durable, both in England and Commonwealth jurisdictions, as well as in the United States, and influenced the case law in this area well into the present century,\textsuperscript{50} although, as will be seen later, the extension of his principle by the United States Supreme Court to justify the validity of general regulatory statutes proved to be controversial. The source of this controversy arose in part from the broad analogies which were drawn in some of the earlier American authorities between Lord Hale's traditional categories, such as wharves and ferrymen, and other more modern undertakings less directly connected

\begin{quote}
employment extends; and for refusal an action lies, as against a farrier refusing to shoe a horse, against an innkeeper refusing a guest, when he has room, against a carrier refusing to carry goods, when he has convenience, his wagon not being full." These developments were noted by Pound in his pioneering work, \textit{The Spirit of the Common Law} (Marshall Jones Co, Boston, 1921) at p 14. See also Editorial Note, "An historical perspective on utilities" (1990) 1 Util LR 3.
\end{quote}

\textsuperscript{48} See for example \textit{Trespass on the Case in Regard to Certain Mills} (1444) YB 22 Hen VI, f 14, where Newton J in the Court of Common Pleas, contrasting the position of a ferry operator with that of competing mills, observed: "...in your case you are required to maintain the ferry and to operate it, and repair it for the convenience of the common people..."

\textsuperscript{49} See Craig, "Constitutions, Property and Regulation" [1991] Public Law 538 at p 540: "...the origin of the term common calling was simply a service that was available to the public generally, a 'holding out'. There could therefore be common carriers, common inn keepers, and common millers. Those who exercised a common calling had a duty to serve at a reasonable price. Historically, this obligation appears to have evolved due to economic and social conditions. In times of social hardship, such as the period following the Black Death, it might be possible for a tradesman to exact 'any price he pleased'. The obligation to serve at reasonable prices was intended to counteract this potential for abuse of market power. As the law developed, the types of industry which retained the label 'common' tended to be those which possessed a monopoly character, such as railways and public utilities." In a similar vein see Adler, "Business Jurisprudence" (1914) 28 Harv LR 135 at pp 153-158; Arterburn, "The Origin and First Test of Public Callings" (1926-27) 75 U Penn LR 411.

\textsuperscript{50} For a comprehensive recent discussion of these principles, tracing the enduring influence of Hale's views on public utilities law, see Taggart, "Public Utilities and Public Law" in Joseph (ed), \textit{Essays on the New Zealand Constitution} (Law Book Co, Sydney, 1995). These principles also took root in Scotland, as Professor Prosser has pointed out. See Prosser, "Privatisation, Regulation and Public Services" [1994] Jur Rev 3 at 10, citing \textit{Aiton v Stephen} (1876) 3 R (HL) 4.
with the provision of services in the public interest, such as grain warehousing, sales of theatre tickets, fees of employment agencies and sales of petrol for motor vehicles.\(^{51}\) However the idea that a utility company has an obligation in the public interest to supply all of its customers without discrimination and at a reasonable price is one which has found favour at some time or another in almost all common law jurisdictions.\(^{52}\)

These developments in the legal concept of the public utility were paralleled at the level of economic theory by corresponding theoretical analysis. The classical economists, such as Adam Smith, far from being opposed to all government intervention in economic affairs (as some, more recent commentators might have us believe) recognised the reality that economic regulation by the state was likely to remain inevitable.\(^{53}\) This was especially the case given the propensity of merchants and others to use every available opportunity to preserve their own position.\(^{54}\)

It may be, as later critics (notably Marx) have argued, that theories such as those advanced by Smith and other accounts of the processes of capitalism from this period failed to envisage the changed circumstances of the next two centuries, including wholesale industrialisation, massive unemployment, the growth of international

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\(^{51}\) For a discussion of the application in the United States of Hale's ideas in this area see Hamilton, "Affectation with Public Interest" (1930) 39 Yale LJ 1089 at 1089-1090; Jones, supra note 34; McAllister, "Lord Hale and Business Affected with a Public Interest" (1930) 43 Harv LR 759.

\(^{52}\) A selection of cases illustrating this principle or derivations from it is set out in Taggart, supra note 50. Some examples are: Allnutt v Inglis (1810) 12 East 527, 104 ER 206; Minister of Justice for the Dominion of Canada v City of Levis [1919] AC 505 (PC); State Advances Superintendent v Auckland City Corporation and the One Tree Hill Borough [1932] NZLR 1709; St Lawrence Rendering Co. Ltd v Cornwall [1951] 4 DLR 790; Nebbia v New York 291 US 502 (1954).

\(^{53}\) Smith, The Wealth of Nations, supra note 8, Book I, p 159, on the regulation of the price of bread: "Where there is an exclusive corporation, it may perhaps be proper to regulate the price of the first necessary of life. But where there is none, the competition will regulate it much better than any assize." See also Book II, pp 344-345 (on the need for regulation of the issue of promissory notes by bankers as a means of effecting payment to traders): "Such regulations may, no doubt, be considered as in some respect a violation of natural liberty. But those exertions of the natural liberty of a few individuals which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments; of the most free, as well as of the most despotical."

\(^{54}\) Smith, supra note 8, Book III at p 437: "All for ourselves, and nothing for other people, seems, in every age of the world, to have been the vile maxim of the masters of mankind. As soon, therefore, as they could find a means of consuming the whole value of the rents themselves, they had no disposition to share them with any other persons."
oligopolies of immense power and seemingly uncontrollable economic fluctuations.\textsuperscript{55} While such criticisms may be justified in part, they would have required Smith to have a much clearer crystal ball than not only all of his contemporaries but also many who came later. Smith himself was under no illusions that the unrestrained quest for profit on the part of merchants and landowners could have detrimental effects.\textsuperscript{56} He was also among the first to identify the consequences of market failure and the need to impose external controls where this had occurred.

It was not long before some of Adam Smith's successors recognised the need to control the activities of the emerging public utility companies in the public interest. The Scottish economist John Ramsey McCulloch, writing in 1825, advanced the view that the dividends of public utility companies ought to be made subject to control by the state in order to prevent those companies exploiting their monopoly positions.\textsuperscript{57} Others, such as John Stuart Mill, believed that monopoly power would gradually be eliminated by the pervasive effect of competition.\textsuperscript{58}

Perceptions of the need to control natural monopoly power in the public interest are therefore not new. Indeed they predate the modern public utility company by several hundred years. Sir Matthew Hale would have had little difficulty in comprehending the need for enforceable regulatory powers in the economic sphere in the twentieth century. The striking thing is that so many of the lessons of the past have tended to be ignored in the present.

\textsuperscript{55} For a recent defence of Smith's approach in the light of these criticisms see the biography by Ross, \textit{The Life of Adam Smith} (Clarendon Press, Oxford, 1995), who notes at p 420: "...in facing up to a world where there is roguery and oppression, he counsels self-command, not abnegation. In all this, he strikes the casual reader as not cynical but realistic."

\textsuperscript{56} See for example the passage quoted in note 54, supra.

\textsuperscript{57} See McCulloch, \textit{The Principles of Political Economy} (Routledge/Thoemmes Press, London, 1995, facsimile reprint of 4th ed, 1849, first published Edinburgh, 1825) at p 299: "Still, however, there are many cases in which it is for the public advantage that companies with such [natural monopoly] privileges should be established, under proper regulations. ...[I]n authorising the establishment of companies for such purposes, such conditions should be inserted in the acts as may be adequate for the protection of the public interests. This important consideration has, however, been far too little attended to."

\textsuperscript{58} See Mill, \textit{Principles of Political Economy} (1948, reprinted Augustus M Kelley, New York, 1961) at p 67, where the author noted that competition was "... making itself felt more and more through the principal branches of retail trade in the large towns."
2.4.2 The United States Approach to the Public Utility Concept

As in England, the American courts were prepared to recognise at an early stage the validity of exclusive franchises for particular activities, such as turnpikes, ferries, canals and bridges. However, as the nineteenth century progressed, courts in the United States came to recognise that the concept of the grant of an exclusive privilege, especially of an essentially private nature, was likely to constrain industrial and commercial development and these earlier judicial approaches gradually gave way to an acceptance of the need for greater competition in such areas.

The enthusiasm with which the American courts embraced the concept of an activity or business affected with a public interest, at least during the period from 1876 to 1950, also serves in some measure to explain the divergent approaches to public utility regulation which developed in the United Kingdom and the United States. At least one writer has sought to identify the British approach to public utility regulation as being analogous in its rationale to the views expressed in the dissenting judgments in *Munn v Illinois*, and in other later judgments of the US courts which have expressed similar views. These are that industries exhibiting monopolistic features are not liable to government control by virtue of their inherent differences from other industries (in terms of the presence or absence of a public interest element) but simply because of the potential for abuse which is inherent in the exercise of monopoly power.

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60. See Horwitz, *ibid* at pp 138-139: "In short, by the time the Charles River Bridge case was decided by the Supreme Court [in 1837, following the first instance decision of the Massachusetts Court in 1829 cited in note 59], recognition of the need to prevent future exclusive monopolies for transportation was no longer confined to a portion of the political spectrum. The only substantial disagreement turned on the proper means for avoiding the consequences of earlier monopolies...Within less than a generation, judges and jurists had come to agree that a policy in favor of competition was a sine qua non for future economic development."

61. *Supra* note 46.

62. Dimock, *British Public Utilities and National Development* (George Allen & Unwin Ltd, London, 1933), at pp 23-24: "In America the public utility concept has had the effect of creating two fairly distinct categories of business: the private and the public. In England there has been no such clear-cut division. Governmental supervision has been merely a matter of degree. Practically every business is subject to public interference in certain respects. Furthermore,
Finally on this aspect, in an age when public law doctrines are more frequently (and quite properly) invoked to accommodate issues of evolving regulatory policy, the continuing relevance of common law concepts of public service in the area of economic regulation should not be underestimated, as at least two US writers on the subject have recognised. Haar and Fessier traced the evolution of the common law obligation of service and its application in a more concrete context to the Town of Shaw in Mississippi, where the provision of public utility services to the rich and poor sections of the town during the 1960s was manifestly disproportionate, to say the least. Litigation based on Constitutional principles such as non-discrimination was ultimately successful in obliging the local authority in that case to change its policies relating to the provision of public services, but also served to spark an interest on the part of the authors into researching the feasibility of alternative remedies based on common law principles. The resulting book provides a compelling argument for the use of common law doctrines such as universal service in this context.

2.4.3 Summary of the Judicial Approaches in this Area

This brief examination of the origins of the legal nature of public utility services shows that the courts have for at least the past two hundred years recognised that suppliers of public services who for one reason or another occupy a privileged monopoly position

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64. Ibid p 18: "We believe that the common law duty to serve - a doctrine currently lying dormant in the precedents of the courts of the fifty states - will prove more effective than increasingly nonproductive efforts based on federal constitutional theories pursued in federal forums. In the state courts, litigation can then concentrate upon the facts of inequality rather than on distracting and vexing constitutional issues. ... The past yields not only wisps of inspiration, but usable models and normative tools. Social complexity notwithstanding, they imply that inequality and the lack of control over one's life need not be inevitable by-products of modernity and affluence. Indeed, our past may yet teach us the basic meanings of fairness and compassion."
have certain corresponding obligations. These include universal provision of the service to all customers, the charging of a fair and reasonable price and an obligation to provide an adequate and uninterrupted supply of the particular commodity or service. In some cases courts have gone as far as to assert that the obligation on a public utility to continue to supply (or in practical terms, to not resort to disconnection) of the service may endure, albeit in exceptional circumstances, even in the face of non-payment of accounts by the customer in question.  

As in Britain, the work of US economists on the concept of natural monopoly matured during the 19th century. The increasing industrialisation which followed the civil war gave rise to much economic analysis. Some economists recognised that ruinous competition could be as disadvantageous to the public interest as unrestrained monopoly power. Hazlett has expressed the view that there were two traditional economic approaches to the concept of competition on the part of the early American economists.

The second and dominant school of thought identified by Hazlett, which recognised the need for regulation of monopoly power in circumstances where competition was inadequate, came to form the basis for much subsequent US regulatory activity. The

65. See for example dicta in the New Zealand cases of Wellington Gas Company v Patten (1881) 3 NZLR 205; State Advances Superintendent, supra note 52. See also Prosser, supra note 50, pp 13-15.

66. See for example Giddings, "The Persistence of Competition" [1887] Pol Sc Qtly 62 at 76: "Other things being equal, new capital will hesitate longest about entering in to competition with established producers in those industries in which each producer must have a plant that is costly in proportion to the value of the total product of all producers. But the combination that would reap advantage from this hesitancy must face the fact that it is precisely this expensiveness of plant that entails heavy fixed charges - which must be met at whatever sacrifice of profits - and impels competition to a ruinous extreme if more capital is tempted in to the business than the normal social need requires...". See also Wells, Recent Economic Changes (1889, reprinted DaCapo Press, New York, 1970), pp 74 - 111.

67. Hazlett, "The Curious Evolution of Natural Monopoly Theory" in Poole (ed), Unnatural Monopolies: The case for deregulating public utilities (Lexington Books, Lexington, Mass., 1985), pp 6-7: "One [school of thought] accepted the newer market forces simply as empirical amendments to the traditional Ricardian view of competition as the omnipresent and beneficent regulator of economic activity. Another strain soon developed that opposed and eclipsed this view. This latter school discarded the universality of the competitive assumption, focusing on instances in which competition was thought to be too weak a regulator to maximise consumer welfare. In the United States, this view would materialize from two premises: that large corporations were, as concentrations of great wealth, immoral in a strongly normative sense; and, in a positive framework, that in particular natural monopoly markets, competition was not an efficient but a wasteful allocator of resources."
great cartels which flourished in the United States in the period after the Civil War sowed the seeds not only for the US antitrust legislation but also for the subsequent system of US economic regulation in the present century.

As will be seen in the following chapters, the early judicial attitudes to the provision of public utility services have tended to endure in recognisable form even in the context of privatised utility companies operating under their own specific legislative provisions. The principles derived from cases such as those referred to above may therefore continue to have some validity, even in an era of widespread privatisation of utility services. Indeed the concept that a business which affects the public interest may be amenable to judicial control in one way or another is one which could conceivably prove to be far more versatile than has at present been appreciated. Its possible application in areas such as consumer protection and controls over the price at which public enterprises are sold into private ownership will be examined later.

2.4.4 The Relationship Between Incorporation and Concepts of Social Obligation

It is instructive to bear in mind that the origins of the concept of the corporation in English law, with its connotations of a state-sanctioned right to carry on commercial activity in a corporate form, are closely related to the grant of privileges of a monopolistic nature, as in the case of public utilities. This fact was recognised by Berle and Means, in their leading work on the evolution of the corporate concept. The nature of these common origins is reinforced when it is recalled that the first English work on the law of corporations, written by Shepheard in 1659, also included within its

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68. Berle and Means, *The Modern Corporation and Private Property* (Macmillan, New York, 1936), p 128, where the authors note: "American law inherited the corporation from English jurisprudence in the form in which it stood at the close of the Eighteenth Century. At that time a corporation was considered as a 'franchise' (Norman-French 'privilege'): i.e., the very existence of the corporation was conditioned upon a grant from the state. This grant created the corporation and set it up as a legal person independent of any of the associates. Infrequently the same grant gave to the corporation other privileges such as a monopoly to run a ferry; a franchise to maintain a railway line in a particular place; a sole right to trade in the Hudson Bay area. Such privileges, except in the case of railways, public utilities and banks, have largely passed out of the picture today." See also the discussion in Raymond, "The Genesis of the Corporation" (1906) 19 Harv LR 350 at 355-358; Schmitthof, "The Origin of the Joint Stock Company" (1939) 3 U Tor LJ 74 at 80-81; Stoljar, *Groups and Entities. An Inquiry into Corporate Theory* (ANU Press, Canberra, Australia, 1973), pp 138-141.
Maternities and guilds, the latter being a primary source of monopolistic practices during the Middle Ages and subsequently. Indeed the analogy between incorporation and the grant of a franchise arose at an early stage of legal thought.

This so-called "concession" theory of company law, which is based on the idea that the privilege or concession of incorporation as a benefit granted by the state requires the corresponding observance of public obligations by the corporators, has been advocated from time to time by legal commentators, such a theory gained widespread acceptance up to the time of the Industrial Revolution. However, as the joint stock company grew in popularity as the preferred vehicle for capitalist endeavour it rapidly became identified with more pragmatic commercial purposes. Today occasional pleas for the recognition of corporate social responsibility can still be found, but, for better or worse, such a doctrine is no longer the central basis of corporate theory. Indeed it runs counter to many of the views that have been expressed by the adherents of public choice theory in these more prosaic times.


70. For a discussion of the common law origins of the concept of corporation see Seymour, "The Historical Development of the Common Law Conception of a Corporation" (1903) 51 Am Law Reg 529 at 541, who notes: "Further, once the [corporate] entity was created it was necessary that its field of action should be defined. This as a matter of convenience was also done in the charter, a fact which has since led to some little confusion of thought. As the age was one in which kings and lords held monopolies of everything there was needed a specific grant of power to act. Hence the modern doctrine which has been evolved from the time when the corporation could do only what it was granted the power to do."

71. See for example the discussion in Parkinson, Corporate Power and Responsibility: Issues in the Theory of Company Law (Clarendon Press, Oxford, 1993), pp 25-32 (who argues that a purely contractual analysis of the concept of incorporation is inadequate to explain all of the legal aspects of corporate bodies); Cooke, Corporation, Trust and Company (Manchester University Press, Manchester, 1950), who contends that the public interest origins of the corporate concept were accepted until the early 19th century.


73. See for example Milton Friedman in Steiner, Issues in Business and Society (Random House, New York, 2nd ed, 1977), at p 168, who asserts in typically uncompromising fashion that: "The social responsibility of business is to increase its profits" and the pursuit of any other goal is "pure unadulterated socialism" which would "thoroughly undermine the very foundations of our free society".
In the United States, the identification of the corporation with public interest goals gained some initial backing,\(^74\) and expressions of judicial support for such an approach can be found in some American decisions in the early 19th century.\(^75\) However, this view proved to be short lived and by 1819, when the US Supreme Court held that a corporate charter was essentially contractual in nature,\(^76\) it quickly lost ground. Although there are examples of subsequent US cases in which the corporate relationship has been analysed in terms of public and private elements, this has invariably been in the context of a contractual framework.\(^77\)

By the mid 19th century the corporate entity had come to be irrevocably identified with private commercial activity in the United States.\(^78\) This decline in judicial and theoretical recognition of the social obligations of corporate entities eventually gave rise to the corresponding need, particularly in the United States but also in Britain, for externally imposed regulation in the public interest. In the UK an era of nationalised ownership in the post-war period witnessed a brief resurgence in the concept of the public corporation, established to serve the public interest, but even here the practice unfortunately often did not live up to the theory, as will be seen shortly. Hopefully in the future a more enlightened system of company law will seek to recognise (or impose) defined social obligations on corporations, thus minimising the need for

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74. See the discussion in Horwitz, *supra* note 59 at pp 109-116.

75. See for example *Currie’s Administrators v Mutual Assurance Society* 4 H & M 315, 347-348 (1809, Va) per Roane J: "With respect to acts of incorporation, they ought never to be passed, but in consideration of services to be rendered to the public... It may be often convenient for a set of associated individuals to have the privileges of a corporation bestowed upon them; but if their object is merely private or selfish; if it is detrimental to, or not promotive of, the public good, they have no adequate claim upon the legislature for the privileges."

76. See *Re Dartmouth College* 17 US 518 (1819) and the discussion of this case in Stites, *Private Interest and Public Gain: The Dartmouth College Case, 1819* (Mass UP, Amherst, 1972).

77. See for example *Morris et al v American Public Utilities Co* 122 A 696 (1923); *Davis v Louisville Gas Co* 142 A 654 (1928).

external regulation of economic activity in the public interest. However, at present such a possibility seems remote.\textsuperscript{79}

2.5 Regulatory Activity in Victorian England

2.5.1 Regulatory Lessons from the Victorian Era

The Victorian era witnessed the first systematic government attempts to regulate monopoly power in England and to introduce external regulatory structures into specific areas of economic and social regulation. Some of these early attempts at regulation were less than entirely successful but their form, and their relationship to prevailing political and economic philosophies of the time, provide some valuable lessons for our own time.

The period of Queen Victoria's reign was one of unprecedented growth in the British economy, accompanied by the transition from an agricultural to an industrialised state. Industrialisation was accompanied by profound changes in the social structure, including the growth of an industrial proletariat of factory workers together with an industrial bourgeoisie formed from within the middle classes. It also witnessed an increasing contrast between minority wealth and mass poverty, although technical progress and economic growth created employment and led to increases in productivity through the specialised division of labour.\textsuperscript{80}

\textsuperscript{79} Parkinson, \textit{supra} note 71, notes at pp 433-434 that in an age of global competitiveness one of the principal difficulties confronting any such revision in existing company law theory would be the need to introduce a new system into all jurisdictions. Merely expressing this thought illustrates the difficulty of the task.

2.5.2 An Era of Laissez-Faire?

The Victorian era has often been regarded as a high point of economic liberalism, and is sometimes termed an age of *laissez faire*. It is useful in the present context to give some consideration to this concept and its implications in terms of regulatory doctrine. To begin with the meaning of the term, the historian Crouzet has provided a succinct definition.81

In his seminal monograph on whether or not the concept of *laissez faire* represented an appropriate description of government policies in 19th century Britain, Taylor referred to the various definitions of the term which have been advanced. He noted that its meaning varied according to the context in which it was employed, and depended greatly on whether the contextual perspective was that of economics, politics or social policy.82

For some time the view held sway that the Victorian era provided a classic example of *laissez-faire* policies in action. This was certainly the perspective adopted by Dicey, who considered that the doctrine, with its undertones of Benthamite liberalism, was the dominant ideology during much of the 19th century, and the enthusiasm of Dicey's support for the concept occasionally overflowed in his writings.83 Modern historians

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81. Crouzet, *ibid* p 105: "*Laissez-faire* is both an economic doctrine and the policies which actually enforce it. The basic principle is that the welfare of both the community and individuals is best served when markets for goods, capital, land, labour and so on are left to the free play of supply and demand, and when the state interferes as little as possible, in both the economic and the social sphere."

82. Taylor, *Laissez-faire and State Intervention in Nineteenth-Century Britain* (Macmillan, London, 1972), p 11, where he noted: "There are some who would appear to equate laissez-faire with anarchy. Others, notably Carlisle and Spencer have identified it with 'anarchy and the constable' or the 'negatively regulative' state. At the other extreme are those who use laissez-faire to mean no more than a preference for private rather than public enterprise. More frequently, laissez-faire has been used as a convenient short-hand for the general prescriptions of the Classical economists and in particular for a belief in the efficacy of a free market economy. In a more precise form it has been regarded as synonymous with free trade - the moreso when free trade is extended, as it was in the nineteenth century, to cover the markets in land and labour as well as in goods."

83. Dicey, *The Relation Between Law & Public Opinion in England during the Nineteenth Century*, (Macmillan, London, 2nd ed, reprint, 1962) at p lxii: "...the dogma of *laissez faire* has commended itself, and does commend itself to hundreds of Englishmen, and for very obvious reasons. It has stimulated energy of action. It has left room for freedom of thought and individuality. It has fostered the trust in self-help. It has kept alive emphatically the virtues of the English people,"
have tended to take a more critical view of the link between *laissez faire* and government policy during the Victorian era, although opinion on this aspect is far from being unanimous.\(^{84}\)

Taylor, in the course of his evaluation of the question of whether or not the Victorian era did in fact represent an age of *laissez-faire*, also noted the dichotomy which existed in that period between libertarian principles which gained their expression in the context of an age of social reform. Like Crouzet, he took the view that in the purely economic area government policies during the Victorian period could legitimately be described as *laissez-faire* and that even in the context of social policy the limitations of government action were readily discernible.\(^ {85}\) He considered that while government interventionism was evident in a number of areas, particularly in relation to social issues such as child labour, the factory legislation and urban health measures, such activity was largely pragmatic in origin.\(^ {86}\) Taylor’s conclusion was that the Victorian commitment to *laissez-faire* essentially arose from the lack of any explicit theory of economic growth, so that *laissez-faire* doctrine effectively represented the Victorian approach by default.\(^ {87}\)

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84. Crouzet, for example, draws a distinction between government action in the social sphere (which was often interventionist in nature) and activity in the economic sphere, where in his view *laissez-faire* principles largely held sway. See Crouzet, *supra* note 80, at pp 105-112. The author notes at p 109: "Actually, as the victory of free trade was so important and the first measures in social legislation were so limited in character, it would be wise to place the high noon of laissez-faire in the mid-Victorian period, and one can admit that it experienced some decline after 1870. But, as a matter of hard fact, this decline was very limited... As for the strictly economic sphere, where humanitarian considerations were not as important, laissez-faire won the day easily and continued to do so, in spite of a few reverses in special cases, where the advantages of intervention outweighed its inconveniences or the consequences of inaction."

85. Taylor, *supra* note 82, pp 53-64.

86. Taylor, *supra* note 82, pp 55-56, where he noted: "Intervention was prompted not by any conviction of its innate desirability but by the inescapable need to meet pressing problems, created largely by the twin forces of industrialisation and urbanisation, which were incapable of individualist solutions. The governments of early and mid-Victorian England did not so much seek to provide new remedies for old problems as to come to terms with the new crises which accompanied a rapidly changing social order."

87. Taylor, *supra* note 82, p 64: "Thus, though laissez faire was on more than one occasion honoured in the breach in Britain itself and still more clearly subverted in the economic policies applied to Ireland and India, it was until at least 1870, and arguably for a further twenty-five years beyond that, the strongest impulse influencing the shape and character of governmental economic policy."
However, as others such as Kitson Clark have pointed out, the debate on laissez-faire may in the end be unproductive. Its relevance for our present purposes lies in the analysis of the regulatory framework which was introduced against the background of the economic and political climate referred to above. To return to Dicey's hypothesis, he had conceived of a staged division of the 19th century into three discernible periods, with some overlap between them. He considered that the first period was one of relative legislative inactivity, from 1800 to 1830. The second period was that of Benthamism or individual liberalism (from 1825 to 1870) and the third was a period of rising collectivism, from 1865 to 1900.

There has been growing scepticism, especially since the 1950s, about Dicey's theory of the transition from individualism to collectivism over the course of the 19th century. Harold Perkin described the comparison between these two concepts as amounting to a 'false antithesis' and considered that the appropriate transition, in conceptual terms, was between greater and lesser degrees of state participation and regulation. He disparaged Dicey's approach as being that of a 'propagandist with a political purpose'. The assault on Dicey's theories in this area mirrors the similar critique which has been applied by some to his theory of the rule of law. Whether or not Dicey's analysis of the political course of the 19th century is valid as a matter of historical interpretation is

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88. Kitson Clark, *An Expanding Society; Britain, 1830-1900* (Cambridge UP, Cambridge, 1967), p 162: "I do not myself think that the conception of a period of laissez-faire is helpful. It has just enough truth to conceal its defects, which are many, and it is an encouragement to error."

89. See Dicey, *supra* note 83, in which this theory is developed. Both Dicey's theory and his supporting arguments have been the subject of critical comment. See for example Parris, "The 19th Century Revolution in Government: A Reappraisal Reappraised", in Stansky (ed), *The Victorian Revolution*, (New Viewpoints, London, 1973), p 55, who takes the view that there are only two recognisable periods with a dividing line set around 1830. Parris views the first as one of legislative inactivity but the second as being dominated by utilitarian principles. He discounts the influence of collectivism in the period after 1870 and attributes changes in the legislative approach to other, structural factors within government itself.

90. Perkin, "Individualism versus Collectivism in Nineteenth-Century Britain: A False Antithesis" (1977) 7 J of Brit Studs 104. See also Bartrip, "State Intervention in Mid-Nineteenth Century Britain: Fact or Fiction?" (1983) 23 J of Brit Studs 63, who expresses the view that it was not until the 1890s that effective state intervention, manifested in cogent enforcement measures such as inspection and reporting, began to have a noticeable effect.

a matter which is likely to remain controversial among historians. However, there is no doubt, as will be seen shortly, that bureaucratic regulatory structures in one form or another steadily evolved over the course of the Victorian era.

2.5.3 Regulation of Monopoly Power in Victorian Times

The Victorian treatment of monopoly power is also deserving of examination. The Industrial Revolution gave rise to some unforeseen issues in this area. One area in which monopoly practices quickly became evident was in relation to railways. The rapid growth of rail transport in England during the 1830s and 1840s quickly led to a recognition that railway companies constituted an effective monopoly over their own particular routes.

Monopolistic railway practices soon became evident. It was not long before the steam railways came to dominate long range goods deliveries, proving obviously more efficient than horse-drawn and canal-based delivery methods. One manifestation of this monopoly position arose in relation to the carrying of small parcels. This was an area in which many of the railway companies deliberately set out to squeeze other carriers out of business by offering preferential rates to customers who dealt directly with the railways rather than through the agency of such intermediate parties.

As Kostal shows in his recent analysis of what he terms the "small parcels war" between the railway companies and the connecting carriers, the courts proved in the

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92. See Parris, supra note 89 at p 55.

93. This de facto monopoly situation received early judicial recognition. As Lord Denman succinctly expressed the matter in R v London and Southwestern Ry Co. (1842) 1 QB 558 at 579, 113 ER 1246 at 1254: "The supposition again of a free competition of carriers on the same railway is practically little else than absurd." Such views accorded with the approach taken by contemporary political economists such as John Stuart Mill, who wrote in 1871: "There are some things which, if allowed to be articles of commerce at all, cannot be prevented from being monopolized articles. On all such the State has an acknowledged right to limit the profits. Railways, for instance, are inevitably a monopoly, and the State, accordingly, sets a legal limit to the amount of railway fares." (Mill, "Land Tenure Reform" in Essays on Economics and Society (Robson (ed), Routledge & Kegan Paul, London, 1967), p 690.)

94. For an interesting recent discussion of monopolistic aspects of the 19th century railway system, particularly in the freight area, see Kostal, Law and English Railway Capitalism 1825-1875, (Clarendon Press, Oxford, 1994) at pp 183-221.
end to be the only effective bulwark against the abuse of monopoly power. In a series of cases in the mid 19th century the English courts issued injunctions prohibiting the railway companies from barring access to small carriers and thereby effectively monopolising the parcel handling trade. The judges achieved this result by giving a liberal and purposive interpretation to the "equal accommodation" provisions of the empowering railway legislation. This required the railway companies to offer their services on equal terms to the whole of the public, including other commercial operations such as intermediate carriers, that hoped to profit from access to the railways. For those who believe in the truth of the saying that the more things change, the more they stay the same, it is interesting to observe that concern about regulating access to rail freight infrastructure was one area which was recently addressed in some detail by the Government in its 1992 White Paper on British Rail Privatization.

The lesson for our times from this episode from the Victorian era is that an alert and vigilant judiciary, assisted by a basic regulatory framework in the form of legislation guaranteeing equal access to railway services, was able to prevent an unrestrained drive to monopoly power on the part of the railway corporations throughout much of the 19th century. In so doing the judges gave effect to Adam Smith's perception that efficient methods of transport could be instrumental in breaking down monopoly influences

95. For examples of leading cases see Crouch v London & Northwest Ry Co. (1849) 2 Car & K 789, 175 ER 331; (1854) 9 Ex 557; Baxendale et al v Great Western Ry Co (1858) 5 CB (NS) 309; Garton v Bristol and Exeter Ry Co (1861) 1 B & S 112, 121 ER 656.

96. Kostal, supra note 94, p 221: "What little could be done by Victorian judges to reconcile the theory of political economy with the reality of railway monopolism, the bench did all in its power to enter the ideological breach, and (attempt) to rescue one group of business interests from the commercial aggression of another. Sentimentality about free commerce and traditional suspicion of corporation prevailed over the business freedom of the railway leviathans. Although the common law had neither procedures or penalties sufficient to end the small parcel war, persistent judicial hostility towards corporate monopolism created just enough legal and commercial space to ensure the continued existence of the hardiest independent parcel handlers." As Hannah notes in The Rise of the Corporate Economy, (Methuen, London, 2nd ed, 1983) at p 12: "...the new problems of regulation which the railways posed fitted uncomfortably in the Victorian compromise of private enterprise, laissez-faire and regulation by competition rather than by the state."

through improved market access, providing that they did not themselves constitute unrestrained monopolies.\textsuperscript{98}

Perhaps if the judges could be relied upon consistently to apply theories of economic intervention in the public interest this could serve to minimise the need for recourse to regulatory bodies. However, as subsequent experience has shown, and as will be seen in later chapters, judges are by training and experience often less well suited to grappling with complex economic and regulatory issues than are other more specialised tribunals.

2.5.4 The Evolution of Administrative Regulation

At the beginning of this chapter a possible resemblance, at least at a superficial level, was noted between the economic and political climate of mid-Victorian England compared with that of the post-nationalisation era of twentieth century Britain. It is useful to include here some discussion of the Victorian approach to government regulation to ascertain if there are any historical parallels with the present century, and whether anything can be learned from the Victorian experience in this area.

In the years between 1830 and 1850 considerable legislative intervention occurred in at least four aspects of Victorian social and economic life, including the areas of factory legislation, the Poor Law, railways and public health,\textsuperscript{99} as Craig has pointed out.\textsuperscript{100}

\textsuperscript{98} Smith, \textit{The Wealth of Nations}, \textit{supra} note 8, Book 1, p 165: "Good roads, canals, and navigable rivers, by diminishing the expense of carriage, put the remote parts of the country more nearly upon a level with those in the neighbourhood of the town. They are upon that account the greatest of all improvements. They encourage the cultivation of the remote, which must always be the most extensive circle of the country... Monopoly, besides, is a great enemy to good management, which can never be universally established, but in consequence of that free and universal competition which forces everybody to have recourse to it for the sake of self-defence." While Adam Smith wrote these words in 1776, before the beginning of the railway age, the basic principle remains the same.

The machinery of administration itself frequently involved use of a system of boards with specific structures and powers. An early example was the Poor Law Commission, constituted in 1834. Other examples were the General Board of Health and the Board of Woods, Forests and Land Revenues. These boards were established under specific statutory authority, the Poor Law Amendment Act 1834 being the relevant legislation in the case of the Poor Law Commission.

As we have seen there has been ongoing debate as to whether or not such interventionist measures serve to negate *laissez faire* conceptions of the nature of government and politics in the Victorian age. Some historical commentators, such as Roberts, have noted that many of the Victorian social reforms can be traced back to paternalistic concepts of society in the early Victorian years.¹⁰¹

Regardless of the philosophical justification for the reforms which took place, it is useful for our present purposes to devote some attention to the way in which a system of boards evolved in Victorian times. A number of writers have addressed the development of the board system and the way in which it fluctuated during the 19th century. Parris points out that the board system was commonly used in British public administration up to the time of the First Reform Act, at which time the administrative structure of government in England consisted of some twelve ministries of state and sixteen boards.

However, the period after about 1855 witnessed a decline in both the formation and authority of the boards in favour of administration through the permanent civil service and government departments. The reasons for this appear to have been varied. Parris identifies questions of continuity, the large and unwieldy nature of many of the boards

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¹⁰⁰ Craig, *ibid* p 35: "For the administrative lawyer they [the Victorian reforms in economic and social areas] are of particular interest because they gave rise to forms of administrative control and debates over the appropriateness of public institutions which are still very much current today."

¹⁰¹ Roberts, *supra* note 99 at p 45: "None of the paternalist writers was systematic in his analysis of the proper functions of government. Their many deeply held beliefs about property, maxims of trade, and voluntarism and their tendency to look to a spiritual regeneration within the status quo, led them to oppose the growth of a more active government. But they also, on other occasions, had reasons - authoritarian, humanitarian, and self-interested - to call loudly for a more active government, for one that protected children from rapacious manufacturers, farmers from cheap foreign grain, and merchant shippers from foreign competition."
and the often diluted sense of public responsibility on the part of board members, compared with individual civil servants. There were also questions of accountability which arose, particularly concerning the appropriate way in which boards and their members could be made directly responsible to Parliament.102

Willson, in his important article on the subject published in 1955, analysed the comparative use of Ministries and boards in British public administration from 1832 onwards.103 He noted that governmental concern about the constitutional accountability of the boards, including their degree of independence from Ministerial control, led to decreasing use of boards as an administrative device in the period between 1855 and 1906.104

In applying his theory to the case of the Poor Law Commissioners, Willson noted that, especially during the period 1834-1847, they fulfilled a controversial role and their separate status made direct control by Parliament difficult if not impossible.105 Perhaps the real historical significance of the Poor Law Commission, at least in constitutional and political terms, is as an illustration of the way in which an

102. See Parris, Constitutional Bureaucracy. The Development of British Central Administration since the Eighteenth Century (George Allen and Unwin Ltd, London, 1969) at pp 82-93.


104. Willson, ibid pp 48-49: "The first, and indeed the major, cause of the decline in the use of boards after the middle years of the 19th century was the growing realisation on the part of the House of Commons of the possibilities of its new position vis-a-vis the administrative organs of the State. It took more than twenty years (during which, as which we have seen, boards flourished) for the House to be finally convinced that the device which offered the best means of ensuring that administration was carried out in accordance with its wishes was that which had already grown up during the previous half century or more - the individual responsibility of Ministers."

105. Willson, supra note 103, pp 50-51. Bagehot, in his book The English Constitution (Fontana Press reprint of the 1867 edition, London, 1993) noted that the example of the Poor Law Commissioners was a good illustration of the difficulties which an independent statutory board would inevitably encounter when working in a highly political area. He observed at p 194: "The experiment of conducting the administration of a public department by an independent unsheltered authority has often been tried and always failed. Parliament always poked at it, till it made it impossible. The most remarkable is that of the Poor Law."
An independent statutory commission was able to come into increasing conflict with Parliament, leading to restrictions on its activities and powers.\textsuperscript{106}

In the context of public utilities, the Victorian era also witnessed interesting developments in the use of boards, commissions and other regulatory techniques. During the early part of the century the aim of the legislature was to promote competition and restrict the exercise of monopoly powers. The advantages which might accrue from interconnection and common use of transmission facilities, as in the case of gas, were largely ignored. Wasteful duplication of facilities and installation work, with attendant public inconvenience, frequently occurred.\textsuperscript{107}

By the 1840s it had become apparent that the requirements of efficiency in the provision of public utilities required the acceptance of some degree of monopoly power, which in turn needed to be regulated in the public interest. Parliament accepted in 1847, with the passing of the Gasworks Clauses Act of that year, that limited local monopolies for gas companies were necessary to overcome the need to lay competing pipelines and the consequent disruption of roads and civic amenities which this entailed. This legislation reflected the growing recognition of the concept of natural monopoly which was gaining recognition among writers on political economy of the period, such as John Stuart Mill.\textsuperscript{108} The emerging utilities, such as gas and water,

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\item \textsuperscript{107} See for example Trench and Hillman, \textit{London under London: A Subterranean Guide} (John Murray Publishers, London, 1984) at p 9: "With the growing demand for gas, new companies had sprung up throughout the nineteenth century. The streets of London became an obstacle course...There were pitched battles between the workmen of rival companies, who were forever fracturing and tapping each other's mains."

\item \textsuperscript{108} As Mill noted in his 1848 work, \textit{Principles of Political Economy} (Robson (ed), Routledge & Kegan Paul, London, 1967), Book I, chapter IX, p 141: "It is obvious, for example, how great an economy of labour would be obtained if London were supplied by a single gas or water company instead of the existing plurality. While there are even as many as two, this implies double establishments of all sorts, when one only, with a small increase, could probably perform the whole operation equally well; double sets of machinery and works, when the whole of the gas or water required could generally be produced by one set only; even double sets of pipes, if
\end{itemize}
followed somewhat later, during the 1880s, by electricity, were therefore gradually given monopoly powers and some degree of regulation was sought to be exercised through the special Acts setting up each undertaking. These regulatory regimes were later incorporated in various General Acts of Parliament.

In the case of the railways, the emerging industry was the subject of intense legislative activity from the 1840s onwards in a series of Railway Acts, perhaps the most significant being the Railway and Canal Traffic Act 1854. In 1873 a permanent tribunal was established to oversee railway and canal facilities and in 1888 the Railway and Canal Commission was established with extended powers, including the power to regulate freight charges in accordance with a statutory scale.

The other significant development in the provision of utility services during the 19th century was the movement towards the provision of such services at the local level by municipalities which operated their own utility companies. This trend began to break down early in the present century as technological developments gave rise to different electricity generation and transmission techniques and changes in road and rail transport networks favoured the development of more broadly based methods of ownership and control.

This, admittedly brief, survey of regulatory structures during the Victorian era serves to confirm that concern at the political level with the consequences of the exercise of unrestrained monopoly power, particularly in the public utilities area, was a live issue.


110. Examples of these, as set out in Sleeman, *supra* note 109 at p 33, included the Gas and Water Facilities Act 1870, the Tramways Act 1870 and the Electric Lighting Acts of 1882 and 1888.

111. For a generally (unsympathetic) discussion of some of these early attempts at railways regulation in both Britain and the US see Foster, *Privatization, Public Ownership and the Regulation of Natural Monopoly* (Blackwell, Oxford, 1992), chapter 2. For a recent discussion of the evolution of railways regulation in Canada see Benidickson, "The Canadian Board of Railway Commissioners: Regulation, Policy and Legal Process at the Turn-of-the-Century" (1991) 36 McGill LJ 1222.

112. See the account of these developments in Sleeman, *supra* note 109, at pp 35-39.
over that period. The difficulties experienced with the use of independent boards illustrate the fact that Parliament was concerned to maintain a relatively tight rein on the activities of such entities, particularly in relatively controversial areas such as the administration of the Poor Law.

The concerns expressed about issues of accountability in relation to the boards predated similar reservations in the present century about other semi-autonomous structures, such as the public corporation and the modern administrative tribunal. However, the fact that Parliament in those times distrusted the use of administrative agencies as a regulatory medium, understandable as this attitude was at a time when administrative law in its modern form had not been developed, should not blind us to the possibility of using the agency concept as an effective regulatory means a century later. The concerns about accountability and efficiency of operation nevertheless survive unchanged. To this extent the Victorian era affords a parallel with the present day.

2.6 Regulation through Public Ownership - The Public Corporation and the Era of Nationalisation

2.6.1 The Evolution of the Public Corporation in Britain

Before concluding this examination of the historical background to regulatory regimes in the United Kingdom it is appropriate to give some consideration to the concept of the nationalised industry and its attendant structure, the public corporation. As was noted in Chapter 1, public ownership and control is one means of imposing a regulatory regime on industry and is a method which has been resorted to at various times and in varying degrees by most Western economies, including the United Kingdom and to a lesser extent, the United States.

In the United Kingdom, some movement towards aggregated control of certain industries or services, initially at the local level and later at the national level, became evident in the final quarter of the 19th century. A movement on the part of local authorities towards aggregate control in the form of joint operating boards was evidenced by the formation of bodies such as the Mersey Docks and Harbour Board (1880) and later the Metropolitan Water Board (1902). The Port of London Authority
was formed in 1908 and, after the First World War, the Central Electricity Board followed in 1919. Later, in 1926, came the British Broadcasting Corporation and a remodelled version of the Central Electricity Board, followed by the London Passenger Transport Board in 1933. Telecommunications became a state monopoly in 1880 and later came under the control of the Post Office in 1913. British Telecommunications (BT) became a separate state corporation much later in 1981.

In terms of legal and political theory there was of course nothing particularly novel about the use of public corporations formed to carry on aspects of state business. Blackstone reminds us of Plutarch's account of the Roman king, Numa, who sought to end the civil strife in Rome between the Sabines and Romans by incorporating separate societies for each trade and profession. Kelf-Cohen, in his book on British nationalisation, claims an even older pedigree for public ownership of industry, drawing on the example of Athens, which administered the silver mines of Laurium through the ancient equivalent of a public corporation.

Herbert Morrison, later Lord Morrison of Lambeth, was one of the earliest and perhaps the most enthusiastic ideological exponent of the public corporation. As the Morrisonian model has left an indelible mark on the development of the British public corporation some consideration of Morrison's views is indispensable in this context. In his well-known work, Socialisation and Transport, Morrison set out both a

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114. Blackstone, Commentaries on the Laws of England, supra note 38, Book I at pp 468-469. As Plutarch wrote in his Lives (5th ed, London, 1792, Langhorne translation) at p 178: "He [Numa] collected the other artificers also into companies, who had their respective halls, courts, and religious ceremonies peculiar to each society. By these means he first took away the distinction of Sabines and Romans, subjects of Tatius and subjects of Romulus, both name and thing; the very separation into parts, mixing and incorporating the whole together."


philosophical basis for public ownership and also considerable detail on the practicalities of achieving this goal.

To begin with the philosophical basis, this was unashamedly socialistic in approach and from the perspective of the 1990s perhaps appears almost utopian in nature,\textsuperscript{117} although it must be borne in mind that nationalisation was viewed at that time (at least by Morrison and other supporters of the concept) as being more an exciting new adventure about to take place rather than with the experience of hindsight and the insights which it gives into some of the difficulties of nationalised ownership.

Morrison's ideological slant is also evident in his description of the nature and management of the proposed public corporation. He accepted that such a corporation must be a public body with public accountability but considered that it must also be efficient, possessed of a social conscience and attentive to the legitimate rights of consumers and organised labour.\textsuperscript{118} His description of the management of the ideal public corporation cast further light on his own personal philosophical and political convictions.\textsuperscript{119}

In summary then, the Morrisonian model envisaged a public corporation which was to be substantially independent in its operation, largely free from political control or bureaucratic interference and which would pursue legitimate commercial goals in the same way as a private sector enterprise. However, the public corporation would also be accountable to the appropriate Minister in the final instance, and through that Minister

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\textsuperscript{117} See for example the following passage from pp 288-289 of Morrison, \textit{ibid}: "But the full healing powers of Socialism cannot be applied until all the large industries and services are planned and organised for social ends and the people, through the appropriate political and economic organs of the nation, are made the masters and not the slaves of material wealth. In the end that doctrine must be applied to the world as a whole. Sooner or later world economic and political organs must in certain respects be supreme over national ones."

\textsuperscript{118} Morrison, \textit{supra} note 116, p 148.

\textsuperscript{119} Morrison, \textit{supra} note 116, pp 156-157: "The Public Corporation must be no mere capitalist business, the be all and end all of which is profits and dividends, even though it will, quite properly, be expected to pay its way. It must have a different atmosphere at its Board table from that of a shareholders' meeting; its Board and its officers must regard themselves as the high custodians of the public interest. In selecting the Board, these considerations must be in the mind of the Minister."
to Parliament. The responsible Minister was to have powers of appointment and dismissal in relation to the Board. The enterprise was required to produce an annual report and accounts and the Minister could issue general statements of policy in relation to the corporation's activities.

In this way it was envisaged, both by Morrison and by the Parliamentary proponents of the concept, that efficiency of operation and the attainment of commercial objectives would be combined with public accountability and observance of social goals both as an employer and as a provider of services to consumers. This concept, while attractive in theory, proved more problematic in practice, as subsequent experience showed.

2.6.2 The Era of Nationalised Ownership

In terms of structure, the post-war nationalisations which later eventuated relied on individual statutory provisions for the nationalisation of each particular industry, some leading examples being the Coal Industry Nationalisation Act 1946, the Iron and Steel Act 1949, the Electricity Act 1947 and the Gas Act 1948. There was no general statute dealing with industry nationalisation, in the same way, for example, that the structure of local authorities in England and Wales was standardised under the Local Government Act 1972. Nevertheless the public corporation became a well recognised entity both in legal and jurisprudential terms. Dias listed them in his leading work on jurisprudence as a distinct species of legal entity having the distinctive features of a corporation but without human or corporate shareholders and with no subscribed share capital.

The history of the performance and problems of the public corporation in the post-war era has been the subject of extensive and detailed work by lawyers, economists and political scientists and the writer does not intend to traverse this well-trodden ground again here. Specific aspects of public ownership as a regulatory tool, including

120. For a general description of the process of nationalisation and the accompanying legislative framework see Robson, supra note 113, chapters 2 and 3; Hanson, Parliament and Public Ownership (Cassell, London, 1961), chapter 3.


122. For examples of some of this work see, Friedmann, Public and Private Enterprise in Mixed Economies (Columbia UP, New York, 1974); Prosser, Nationalised Industries and Public
issues of accountability and the nature of these entities in public law, will be examined in chapter 3. However, for our present purposes it should be noted that the evaluation of the performance of the public corporation, both as a commercial enterprise and in terms of its achievement of social objectives, is by no means a straightforward task.

Scepticism as to the economic efficiency of public enterprises extends back at least as far as Adam Smith, who doubted, in his usual forthright manner, the ability of governments to manage successfully any sort of business, with the possible exception of the post office. In more recent times there has been no shortage of critics, including numerous economists, particularly from the New Right, who have been quick to assert the inefficiency, if not the incompetence, of public as opposed to private enterprise. Nevertheless the suspicion lingers that the comparison may not be a particularly fair one. It was soon recognised that the Morrisonian ideal of limited

123. Smith, supra note 8, Book V, chapter II, at pp 342-343: "The post office is properly a mercantile project. ... It is perhaps the only mercantile project which has been successfully managed by, I believe, every sort of government. ... Princes, however, have frequently engaged in many other mercantile projects, and have been willing, like private persons, to mend their fortunes by becoming adventurers in the common branches of trade. They have scarce ever succeeded. ... The agents of a prince regard the wealth of their master as inexhaustible; are careless at what price they buy; are careless at what price they sell; are careless at what expense they transport his goods from one place to another. ... No two characters appear more inconsistent than those of trader and sovereign."

124. Typical of these criticisms is that of Stigler in his book The Citizen and the State. Essays on Regulation (Univ of Chicago Press, Chicago, 1975) at p 167 where the author (giving less credit than did Adam Smith for the possibility of the state operating the post office successfully) states: "Somewhat more people believe that regulation is wholly insufficient or inefficient, and that the explicit vesting of much privately owned enterprise in direct governmental ownership and operation is essential to satisfactory social performance. These old-fashioned socialists have always had some trouble discussing the post office; when the sovereign cannot carry small rectangular pieces of paper with either economy or dispatch, one must inevitably worry about his capacity to manage an entire economy." In similar vein see Vickers and Yarrow, "Privatization in Britain" in MacAvoy et al (eds), Privatization and State-Owned Enterprises (Kluwer, Boston and London, 1989) at pp 213-215; Wiseman, "Growing without Nationalisation" in Veljanovski (ed), Privatisation and Competition. A Market Prospectus (IEA, London, 1989), at pp 3-14; Boardman and Vining, "Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed and State-Owned Enterprises" (1989) 32 J L & Econ 1; Foster, "Rival Explanations of Public Ownership, Its Failure and Privatization" (1994) 72 Pub Admin 489.
political involvement in a public corporation's affairs was unlikely to be realised in practice, as commentators such as Crosland have noted.\textsuperscript{125}

Crosland went on to note that such developments made it more difficult for public corporations to pursue normal commercial policy, not only by reason of these forms of political interference, but also because Ministerial intervention often resulted in decision making which did not promote the commercial interests of the corporation. He listed several notorious examples, including an informal agreement on the part of the Coal Board not to increase prices without Ministerial consent (as well as close Ministerial involvement in the past in controversial pit closure decisions) and Ministerial pressure on the Transport Commission to grant larger than proposed wage increases to avert widespread industrial unrest within the railways. Similar examples have been documented in detail by other commentators.\textsuperscript{126}

Against this backdrop, it may not be particularly meaningful to compare the commercial or economic efficiency of public and private enterprise in the United Kingdom on a direct basis, given that public enterprise frequently has to serve more than one master, pursuing both commercial and social objectives simultaneously even where these goals conflict. Experience with the first year of operation of the UK privatised rail network is of interest in this context. Statistics published in June 1996 by the Rail Users Consultative Committee revealed that customer complaints, most frequently about lack of punctuality in train services, overcrowding of carriages (by one franchised operator in particular) and unavailability of travel information, rose by 8% in

\textsuperscript{125} Crosland, "The Private and Public Corporation in Great Britain", in Mason (ed), \textit{The Corporation in Modern Society} (Atheneum, New York, 1980) at p 269: "But a development has occurred which was not foreseen in the discussion prior to nationalization. This is the increasing propensity of Ministers to intervene, not by means of open 'directions', but through informal consultation and pressure over the lunch table or at private meetings. Ministers not only exercise a continuous general supervision over the corporations, but they also intervene to alter or influence specific decisions on major policy; and no Board today would take such a decision without first 'clearing' it with the Minister."

England and a staggering 35% in Scotland to give an overall total exceeding 10,000.\textsuperscript{127} Such a record of poor performance might give even the most blinkered adherents of private ownership considerable food for thought.

Other economic studies draw attention to the fact that the level of market competition, rather than the ownership structure, may be the principal determining factor in enterprise efficiency.\textsuperscript{128} Given the existence of deeply held, not to say deeply divided, ideological views on the comparative merits of public and private ownership, such conflicts are unlikely to be capable of objective resolution even if adequate, unbiased data is available on which to base the appropriate assessment.\textsuperscript{129} However, when considering the issues which arise in this area, the above factors must necessarily be kept in mind.

In more recent times there have been suggestions that the range of policy choice is not restricted to a choice between nationalised public ownership and control and private (or privatised) ownership. It may be that modified forms of public ownership, perhaps utilising the trust concept, or based on state shareholding in commercial enterprises, can provide an acceptable middle ground. These methods have been the subject of some experimentation in other jurisdictions, such as France, Sweden, Italy and New Zealand, where statutory corporate status in one form or another has been conferred on commercial enterprises of a public character and state organisations have either subscribed for shares or have exercised rights of control through nominees.\textsuperscript{130} In New Zealand there has been recent experimentation with issuing shares in privatised municipal power companies to local consumers, both directly and through trust

\textsuperscript{127} See article in the \textit{Sunday Times} of 9 June 1996: "Rail complaints soar after privatisation", summarising the official complaints statistics released by the Rail Users Consultative Committee relating to customer complaints received in the first year of franchised passenger service delivery. See also the discussion in part 4.3.4 of chapter 4.


\textsuperscript{129} Professor Prosser has noted some of the conflicting studies in this area: see note 122, supra, at p 235.

mechanisms, an approach which has met with varying degrees of success (and has also spawned a good deal of litigation). Similar, more innovative approaches to public ownership have been advocated in the United Kingdom.

Such developments serve to illustrate that policy choices are sometimes not as narrowly defined as some politicians and economists would have us believe. Chapter 3 considers further whether modified forms of state ownership and participation can constitute an effective regulatory regime and some of the difficulties which would need to be resolved for this to occur.

2.7 The Privatisation Movement

Privatisation has become one of the catchwords of the 1980s and 1990s. The enthusiasm of its adherents at times appears to be almost unbounded. It is not part of the present task at hand to enquire into whether objectives such as "rolling back the state", "keeping government out of business", or creating a "property-owning democracy", to quote three of the maxims of the movement, are desirable goals in either economic or political terms, though the reader may discern some scepticism in

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132. See for example Coombes, supra note 122, chapter 12, entitled "A New Style of State Enterprise".

133. See for example Shirley, "The What, Why, and How of Privatization: A World Bank Perspective" (1992) 60 Fordham LR S23 at S31-S32, where the author states: "The present interest in privatization is no fad. What we now see is a restructuring of the balance between the public and private sectors.... Lessons have been learned, however, and today's strategies reflect these lessons. Markets fail, but so do governments. The public enterprises were unable to meet all their ambitious goals; instead, they sometimes undermined the very objectives they were created to serve." Another example can be found in Veljanovski, Selling the State. Privatisation in Britain (Weidenfeld & Nicolson, London, 1987) at p 2. For useful general discussions of the privatisation process in Britain see Kay, Mayer and Thompson, Privatization and Regulation - the UK experience (Clarendon Press, Oxford, 1986); Vickers and Yarrow, Privatization: An Economic Analysis (The MIT Press, Mass. & London, 1988).
the following chapters as to whether privatisation is the cure-all that it is often claimed to be. However, the process of privatisation, and its implementation in practice, can have certain foreseeable influences on the need for a regulatory regime and on the form of regulation which it may be considered appropriate to adopt.

The transformation of industries or undertakings of a monopolistic nature from public to private ownership may lead to the abuse of a monopoly position if the transition does not take place in the context of a structure in which genuine market competition is brought into existence, or where appropriate regulatory mechanisms are not put in place. This is one of the areas in which the process of privatisation in Britain may have fallen short of the ideal, as will be discussed in subsequent chapters.

One of the persistent criticisms at a philosophical level of the privatisation process in the United Kingdom (apart from the more fundamental one, articulated in memorable terms by the late Harold Macmillan, Lord Stockton, of selling off the family silver to buy the groceries) revolves around the way in which the process was implemented. Several commentators have pointed to the overriding influence of Treasury requirements as a motivating factor in both the speed and form of privatization. Cox has drawn attention to the financial imperatives underlying the process. Other commentators have made similar points.

Similar observations have been made by some of the economic commentators. The political agenda, in the form of securing the allegiance of contented voters who have

134. Cox, "The Politics of Privatisation" in Robins (ed), Politics and Policy-Making in Britain (Longman, London, 1987) at p 156. Cox observed that the underlying rationale behind the privatisation movement was "the need to finance the PSBR [Public Sector Borrowing Requirement]" and that the objects of privatisation were selected as being "anything that could be sold quickly and for a clear profit."

135. Simpson, "Regulatory aspects of utility privatization" (1992) 3 Util LR 183 at 184-185: "The political requirement has been to return nationalised utilities to the private sector and to do so in a way which assures a successful launch of the newly privatised utility on the stock market. In the United Kingdom, utility SOE's shares have been struck at prices designed to encourage wider share ownership, employee share participation and other more general political objectives. There has been a somewhat lower priority to reducing monopolistic powers, the most obvious example being the privatization of British Gas in 1985 which retained intact its vertically integrated monopoly."

subscribed for shares in highly profitable privatised enterprises, while at the same time weakening trade union power, may of course diverge from what might objectively be regarded as desirable economic policy, as less charitable observers have pointed out.\textsuperscript{137}

It should be kept in mind here that a political choice between what may be described as collectivist and free market approaches, at the two extremes, will have obvious repercussions on issues of regulatory design. In an era of privatisation, where the emphasis has shifted to the enhancement of private as opposed to public rights, such influences are pronounced. A philosophy which favours a free market approach may well also support minimal government interference in the functioning of the market. If it is assumed that the market is a cure-all in the long run (even if, as Keynes reminds us, in the long run we are all dead\textsuperscript{138}), and that the attainment of welfare goals will be assured by the trickling down of wealth maximised at the top of the social and economic pyramid (even if the pyramid proves to be remarkably absorbent in its upper layers), then mechanisms which seek to alter or modify market processes are unlikely to be greeted with enthusiasm.\textsuperscript{139}

Similarly, if the political agenda dictates that privatisation and the interests of shareholders in privatised industries are to be paramount, a mechanism which favours the interests of consumers is likely to be regarded with similar disdain. Where, as in the United Kingdom, there are few if any constitutional restraints on a process of unrestricted privatisation,\textsuperscript{140} such an agenda may well lead to a situation in which the

\begin{footnotesize}

\textsuperscript{138} See Keynes, \textit{A Tract on Monetary Reform} (Cambridge UP, Cambridge, 1972, first published 1933), chapter 3, p 27: "But this long run is a misleading guide to current affairs. In the long run we are all dead."

\textsuperscript{139} For a more detailed account of the conflict between economics and distributional concerns in this area see Kelman, "On Democracy-Bashing: A Skeptical Look At The Theoretical and 'Empirical' Practice of the Public Choice Movement" (1988) 74 Virg LR 199. The economist J K Galbraith, in his book \textit{The New Industrial State} (Houghton, Mifflin Co, Boston, 4th ed, 1985), has described the trickle-down theory as being equivalent to feeding a horse a large quantity of oats and waiting for some of them to pass through to the road to be eaten by the sparrows!

regulatory regime subjugates the interests of consumers to those of shareholders and industry to an unacceptable degree. Such a situation can be reflected in a variety of ways, including unduly generous pricing formulas, a failure to enforce acceptable standards of service and a lack of effective participation structures which would allow consumer interests to exert a meaningful influence on the regulatory process. At a more fundamental level suggestions have been raised that much underlying political support for the privatisation movement has tended to come from multinational corporations and industrial elites, who have certainly been among its primary beneficiaries.\textsuperscript{141}

A regulatory regime based on a public interest standard could address many of these issues but might quickly come into conflict with the political priorities underlying a system of privatised ownership. Such a wholesale collision of values is not necessarily inevitable. However, greater recognition of the consumer interest would necessarily entail an accompanying degree of political willingness to recognise that share ownership in the privatised industries is not a cast iron investment to be protected at all costs from the normal vagaries of the market. A more moderate political approach, perhaps based on a recognition of the need to reconcile opposing stakeholder interests as far as possible, would certainly assist in bringing about the implementation of a more balanced regulatory regime. If the family silver is to be pawned in exchange for groceries, at least the previous owners should not be left to starve while watching their successors in title dining off the proceeds.\textsuperscript{142}

\textsuperscript{141} See for example the critique of the privatisation movement in Martin, In the Public Interest?: Privatization and Public Sector Reform (Zed Books, London, 1993) at p 95 where the author notes: "Whether or not the greatest ever transfer of public wealth into private hands has also been the greatest ever concentration of wealth to have taken place over such a period is impossible to judge, even in one country, let alone for the whole world. There is plenty of anecdotal evidence, however, that the best of the assets in the South and East have gone to the North and West, and that transnational corporations and local élites have benefited more than anyone else."

\textsuperscript{142} As Johnson aptly puts it in his book, The Economy under Mrs Thatcher 1979-1990 (Penguin Books, London, 1991) at p 173: "The use of asset sales to finance public expenditure was regarded critically by many, including Lord Stockton (formerly Harold Macmillan), as 'selling the family silver'. Mrs Thatcher retorted that she was 'selling it back to the family' - although, if it was theirs, it was not clear why they had to pay for it."
The point of this discussion is not to embark, necessarily, on a criticism of the political imperatives underlying the privatization process (although the selling of state assets at a gross under value, if this occurs, might be thought to be a legitimate source of public concern\textsuperscript{143}) but simply to illustrate that the structure of a privatised industry has a direct bearing on both the necessity for, and the nature of, the appropriate form of regulatory regime which may be required. In particular, to take a concrete example, if public utilities with monopolistic characteristics are privatised in such a way that no adequate competitive structure or price setting mechanisms are put in place, the dangers of possible abuse of monopoly power and the consequent need for some form of regulatory activity to counteract this possibility, are all the greater.

One of the great paradoxes of the British privatisation movement, at least as this writer sees it, is that the professed goal of some of its most ardent supporters, the free marketeers, of allowing competitive market forces free rein, has been deliberately sacrificed in favour of overt political ends. Privatisation as a revenue-earning device has proved in many cases to be quite inconsistent with the concept of privatisation as a means of promoting effective market competition. These considerations will be examined further in subsequent chapters.

2.8 Summary

The following points emerge from the foregoing survey of the historical evolution of regulatory regimes:

- The history of regulation through delegated legislation gave rise to an increasing interest on the part of the courts in overseeing this regulatory

\textsuperscript{143} For examples of sales of public assets in the course of the privatisation process which were said to have taken place at a gross under-value see Coxall and Robins, \textit{supra} note 137, at p 177. The previous Conservative government appears to have conceded as much. The previous Energy Minister, Lord Fraser of Carmyllie, told the Trade and Industry Select Committee on Regulation on 3 February 1997 that "in retrospect one could have an argument about the appropriate share price." See article in \textit{The Times}, 4 February 1997: "Government Concession on Energy".
technique, a trend which ran in parallel with increasing judicial independence from the 17th century onwards;

- The need for economic regulation of monopoly power revealed a divergence of attitude on the part of the judiciary in this area, ranging from reluctant acceptance to extreme hostility. These attitudes have more recently been reflected in the varying degrees to which modern courts defer to the decisions of regulatory agencies;

- The concept of a business or calling affected with a public interest led eventually to the development of the legal basis for modern utility regulation, including the twin requirements of provision of universal service at a reasonable price. These concepts were eventually taken up by the courts in all common law jurisdictions;

- The legal concept of a corporation was initially bound up with the concept of a concession granted by the state, with attendant public interest obligations. However, this approach later gave way to a view of the corporation as being a private, commercial entity, a development which in turn gave rise to the need for external regulation of certain corporate activities;

- In Victorian times the use of independent boards in certain specialised areas led to consideration being given to issues of accountability of those entities to Parliament and the degree of independence which they ought to enjoy;

- The use of public ownership as a regulatory technique gave rise to the theoretical attractions of public accountability and the possibility of observance of social goals coupled with commercial efficiency, but these objectives were not always realised in practice;

- The more recent emphasis on privatisation does not in itself avoid the need for external economic regulation. Political and structural factors remain important and private, as well as public, monopoly still needs to be regulated in the public interest. However, any such regulatory initiatives need to reconcile opposing stakeholder interests.
3. PUBLIC OWNERSHIP AS A REGULATORY TECHNIQUE

3.1 Introduction

This chapter examines the use of various forms of public ownership as a technique of economic regulation. Public ownership has been dealt with separately in this chapter from the various regulatory techniques to be discussed in chapter 4 as it has various unique characteristics of its own.

As will appear from the discussion in this chapter, public ownership can be a more flexible method of regulation than might appear at first glance. Those attuned to think of the concept in terms of moribund public corporations, as in the UK context, or controversial experiments, such as the Tennessee Valley Corporation in the United States, may well remain unconvinced by this assertion. Nevertheless, there have been progressive applications of the concept of public ownership from time to time in various jurisdictions. This chapter will look at some of these developments in Canada, Australia and New Zealand. It will also evaluate the merits of various forms of public ownership in terms of the regulatory benchmarks set out in chapter 1.

This chapter also breaks new ground by including a detailed consideration of some of the theoretical limitations on the flexibility of public ownership arising out of the technical requirements of company law. These impinge particularly on the ability of directors of publicly owned companies to represent a wider mandate than simply the interests of the company itself. The role and effectiveness of nominee directors and the concept of government shareholding in private enterprise will be discussed. Until a solution is found to some of the legal difficulties which will shortly be described, much of the possible benefit of these devices is likely to stay unrealised. In consequence a good deal of the potential for using public ownership as a regulatory advice is similarly likely to remain unfulfilled.

While many tend to view public ownership as stifling under the dead hand of government, the discussion in this chapter will endeavour to show that such a stereotyped view need not necessarily be accurate. While devices to encourage consultation and participation in the decisions of publicly owned entities may be
subject to some unavoidable constraints, there is also much untapped potential in this technique as a whole. As the debate on rail privatisation in Britain currently illustrates, there are many industries in which private ownership does not necessarily lead to undeniably better outcomes for all parties affected by the regulatory process, including consumers, employees and the state, and not merely the shareholders in privatised enterprises.

3.2 An Evaluation of Economic Regulation through Public Ownership

3.2.1 An Assessment of the Strengths and Weaknesses of Public Ownership in Britain

Part 2.6 of chapter 2 discussed the development of the concept of the public corporation in Britain and some of the features of public ownership of nationalised industries in the post-war period. As was noted, the evolution of nationalised ownership in the UK using the model of the public corporation was more than just an economic phenomenon but had a strong underlying philosophical and political basis as well.

As the analyses by leading writers on the subject such as Katzarov have shown, the philosophical identity between the concept of nationalisation and collectivist political doctrine is a strong one, not only in Britain but elsewhere as well. However, as the discussion in the previous chapter also showed, a number of practical difficulties and areas of controversy were encountered under the UK experience of public ownership. These included secrecy of operation and lack of accountability in relation to decision making, direct and indirect political interference in the commercial decisions taken by the boards of the nationalised industries and the old chestnut of whether public ownership was economically inefficient compared with private ownership.

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1. For a discussion of this area see Katzarov and Bradley, The Theory of Nationalisation (Martinus Nijhoff, The Hague, 1964), p 14, where the authors note: "The moral element in nationalisation is considerable, and goes beyond what might appear at first sight merely from the possession of assets by the state and their utilisation in the common interest. The assets themselves and their utilisation represent a real part of the corpus of the nation. It should never be forgotten that between those who exploit their property rights and the thousands of citizens who carry on the activity of production and distribution, a deep gulf has been inexorably fixed under an economic structure based on private property."
On the other hand, various theoretical and practical advantages have also been claimed for nationalised ownership. It has been contended by some that such an ownership structure allowed for overall policy co-ordination of industrial activity on a sectoral basis and also provided channels of accountability by reserving policy making powers to ministers while allowing the individual corporations considerable independence in their daily activities. It was also argued that public ownership could be used to fulfil certain social goals, such as maintaining employment, supporting particular areas of the economy and local communities and assisting in the fulfilment of government policy in various areas. However, as was noted in chapter 2, the theoretical promise of public ownership in Britain unfortunately fell short of a somewhat more prosaic reality.2

Public ownership can be analysed in terms of the benchmarks for assessing regulatory performance set out in chapter 1. To take these regulatory goals in the same order in which they were discussed in that chapter, the first deficiency in the UK regime of public ownership arose in respect of certainty. Here political interference in various ways in the commercial decisions of the nationalised industries often served to defeat the element of certainty required for coherent commercial activity and planning. Secondly, the goal of accessibility, measured in terms of the degree of openness and transparency of the procedures used, was again lacking under this structure. Far from these goals being encouraged under public ownership, the decision making process was often shrouded in secrecy and was accompanied by considerable uncertainty and confusion.3

2. See Craig, Administrative Law (Sweet & Maxwell, London, 3rd ed, 1994), p 99: "The ideal of day-to-day autonomy coupled with ministerial control over long term planning has proven unsuccessful. It has been undermined from both sides. On the one hand, successive governments have used nationalised industry to respond to short term pressures. Long term planning has been upset by ministerial pressure to buy British, to resist wage increases, or to curtail a capital investment programme. Such pressure has moreover been exerted covertly, rather than through the usage of the power to give directions. On the other hand, governments have been notably lacking in the type of broad policy directive envisioned by the enabling legislation." See also McEldowney, Public Law (Sweet & Maxwell, London, 1994), who notes at p 381: "A degree of day to day autonomy was granted to each industry leaving Ministers overall policy and direction. Ministers could influence the membership of the boards of the industry through individual appointment and the giving of general directions. Financial control, especially over borrowing and in major development programmes, was largely dependent on ministerial discretion and sanctions. Generally, the role of the nationalised industries was vague and uncertain and left to the policies of successive governments. ... A common complaint of nationalisation was the lack of information and knowledge of the working of the industry concerned."

Whether public ownership fulfilled the goal of efficiency is an area in which opinions differ, as was noted in chapter 2, and the suspicion remains that an approach of this kind may be too simplistic.\(^4\) However, there is certainly cause to suspect that nationalised ownership in the form in which it was practised in post-war Britain fell short in this area compared with the relative efficiency of private enterprise. This is not to say, however, that such a comparison necessarily holds true in the case of more innovative forms of public enterprise, as will be discussed later in this chapter.

Achievement of the goal of accuracy, which is concerned with the extent to which a regulatory regime reaches an optimal result under a given legislative, economic and political framework, is again controversial in this context. Even under external circumstances which are favourable to the existence of public ownership, the difficulties referred to above suggest that the UK model fell short of the idealised situation envisaged by Morrison and described in chapter 2.\(^5\)

Similarly, when applying the goal of fairness to a regime of public ownership, which requires consideration of the degree to which a fair and equitable balance has been reached between opposing interests in the regulatory process, significant deficiencies are also apparent. Under the UK model the interests of shareholders were of course not relevant as the public corporations had no issued share capital as such. However there is considerable evidence to suggest that the interests of consumers were unduly subordinated to those of the regulated firms themselves and arguably also to the

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4. See chapter 2, Part 2.6. As Martin succinctly expresses the matter in a critical review of the privatisation movement in his book, *In the Public Interest?: Privatization and Public Sector Reform* (Zed Books, London, 1993) at p 7: "Yet the privatization debate has been conducted largely in terms of whether public or private ownership or management is best, generating a lot more heat than light. The dispute is incapable of resolution in general and will therefore endlessly perpetuate itself until it is realised that the question rather than the answer is wrong. Whether you want to prove that public ownership is good and private ownership is bad, or vice versa, there is a constant and abundant supply of triumphs and scandals to bolster your case. Tit-for-tat trading of them has led nowhere. The very basis of the dichotomy is dubious, equating public with state and private with commercial, ignoring forms of organization that are neither, or both, such as the 'third sector', which comprises non-governmental organizations (NGOs), voluntary not-for-profit bodies and the like. It also overlooks the extent to which intersection of the three sectors has contributed to public service delivery." More recent economic analyses in this area have been predicated on the basis that government actions in relation to nationalised industries (such as a continuing tolerance of higher cost structures and consequent weak incentives for managers to achieve cost reductions) can be consistently predicted, which may or may not be the case. See for example Laffont and Tirole, "Privatization and Incentives" (1991) 7 Jnl L Econ & Org 84; Schmidt, "The Costs and Benefits of Privatization: An Incomplete Contracts Approach" (1996) 12 Jnl L Econ & Org 1.

5. See the discussion in part 2.6 of chapter 2.
interests of their employees and management. Similarly, the balance to be struck between the pursuit of economic and social obligations by the nationalised industries was far from settled and was often unclear in terms of basic principle.

So far as the objective of enforceability is concerned, the government had the power to control the policies of the nationalised industry by direct means through the giving of directions. However even here the regime of public ownership fell short of the ideal, given that the lines of government control were frequently blurred and the boundaries between government direction and the autonomy of the boards themselves were often unclear. While in theory there may have been scope for a graduated range of regulatory control strategies, ranging from mechanisms such as seeking amendments to the primary nationalising legislation in Parliament to less direct forms of persuasion, such as the hypothetical late night telephone call from minister to board chairman, the suspicion remains that covert rather than overt means of control represented the preferred option.

These difficulties tie in with the notion of accountability. The essential concept of the Morrisonian public corporation embodied a theoretical difficulty at this level. Whereas public ownership might be thought to lend itself to direct government control over the activities of the nationalised industries, the theory was that the corporations themselves would enjoy considerable freedom in their day to day running. Such a structure was perhaps destined almost inevitably to fall foul of the demands of political reality and indeed this proved to be the case in practice. The converse concept, that of autonomy, also suffered given the seemingly irresistible temptation of successive governments to use the nationalised industries as vehicles for implementing government policy. As Garner has pointed out, the concepts of accountability and autonomy, rather than being complementary, tended to work against each other in the context of the nationalised

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6. For an examination of the ways in which the implementation of nationalised ownership in the UK impacted on the consumer interest see Prosser, supra note 3, chapters 8 and 9.

7. For a good discussion of this issue see Coombes, State Enterprise: Business or Politics? (George Allen & Unwin Ltd, London, 1971), chapter 3, entitled "Social and Economic Obligations." The author notes at p 52: "Nevertheless, for the main part, the social and economic obligations of the nationalized industries do not arise from nationalization and were not created by statute: indeed there is hardly any guidance in the statutes to what the specific obligations of the industries are.... It is still not decided how responsibility for social and economic objectives should be allocated between government and boards; and the associated difficulty of allocating the cost of undertaking obligations in the public interest remains."
industries. Managerial efficiency was hampered by political interference and accountability to Parliament was blunted by organisational design. The public corporations seemed to inherit the worst of both worlds in these areas.

3.2.2 The Approach to Public Ownership in Canada

From time to time differing solutions have been advanced in relation to the various problems of public ownership of industry. In some Commonwealth jurisdictions, notably Canada, Australia and New Zealand, government ownership has been implemented in more recent times through the use of a corporatised structure, under which public enterprises (or state-owned enterprises as they have come to be known in Australia and New Zealand) have been established with an individual shareholding, boards of directors, commercial objectives and other features emulating those of private sector corporations. The use of modified forms of public ownership in these Commonwealth jurisdictions has been the subject of considerable academic and judicial analysis, especially in relation to the New Zealand legislation, and it is appropriate to outline these developments at this point, beginning with the Canadian, and then the Australian and New Zealand experience in this area.

In both Canada and Australia there was an initial tradition of public ownership along similar lines to Britain. The Canadian experience of regulatory regimes paralleled that of the United Kingdom to a considerable extent. Industry regulation in Canada began in the nineteenth century and was first encountered in areas such as canal and railway transportation. Regulation by means of state ownership or control was also in evidence at an early stage. The earliest example of a recognisable predecessor of the public corporation was a statutory Board of Works established in 1841 to build a canal system in the United Provinces of Canada. Several government corporations were subsequently established in the period after Confederation in 1867. This activity was particularly pronounced in the railways area, as was the case in other jurisdictions. This

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8. See Garner, "Auditing the Efficiency of Nationalised Industries: Enter the Monopolies and Mergers Commission" (1982) 60 Public Admin 409 at 426: "The object of all accountability is efficiency. The object of autonomy for the management of nationalised industries is efficiency. In Britain autonomy and accountability have come to be seen as antithetical."
led to the nationalisation of the Canadian railway system in 1919 with the establishment of Canadian National Railways, which was the principal government enterprise in Canada until its recent privatisation.9

In the field of public utilities, especially in the water and electricity industries, municipal ownership was the predominant form of ownership and even today it remains significant in this area. Provincial involvement with public utilities also had a long-standing pedigree, extending back to bodies such as the Hydro-Electric Power Commission of Ontario, which was established in 1907. This is now the largest power utility in North America and is currently being prepared for privatisation by the Ontario State Government.10

A distinctive Canadian form of public corporation emerged during the 1930s and 1940s in the form of Crown Corporations established at the federal level. These corporations were separate corporate entities which were set up under various legal structures. Initially a number of Crown Corporations were established pursuant to separate legislation (examples being the National Harbours Board and the National Research Council of Canada) whereas later examples consisted of companies which were incorporated under the Canadian federal Companies Act of 1934 (such as Atomic Energy of Canada Limited and Polymer Corporation Limited).11

A system of classification of Crown Corporations, including provisions as to their financial administration and accountability, was incorporated in the Financial Administration Act (RSC 1970, c.F-10). This Act divided Crown Corporations into "departmental", "agency" and "proprietary" corporations depending upon whether, in

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10. The government of Premier Mike Harris, returned in Ontario for a further five year term in June 1995, has announced that it intends to proceed with the privatisation of Ontario Hydro during its current term of office. See Theil, supra note 9, pp 51-52.

general terms, they delivered government services, managed government trading or service operations, or produced goods or supplied services to the public on a commercial basis. Concerns over the political accountability of the Crown Corporations were evident in Canada, as in other jurisdictions, and these were the subject of a Green Paper issued by the Canadian government in 1977.  

This paper put forward various proposals which were designed to clarify and define the relationship between the federal government and Parliament, and between the Crown Corporations and their management. It made a number of recommendations, including proposals for ensuring adequate flows of information from the corporations to the government through detailed reporting mechanisms. Closer controls over executive salary levels were recommended (a matter which might be thought to be of some topical relevance in the United Kingdom context in relation to the privatised utility companies). Comprehensive financial planning procedures coupled with systematic audit controls and borrowing procedures were also contained in the report.  

Similar recommendations, including the preparation of an annual corporate plan covering the succeeding three year period and a procedure for the issue of general Ministerial policy directives, were made by a Canadian Royal Commission in the Lambert Report in 1979.

Concerns were expressed that these proposals would lead to Crown Corporations having to fulfil too many different and potentially conflicting roles. These reservations were reminiscent of those which had been expressed in relation to the public corporation in the United Kingdom, as was seen in chapter 2, and which have also arisen in relation to state-owned enterprises in the New Zealand context, as is set out below. Sexty has described the Canadian position in his 1979 article on the subject.


15. See Sexty, supra note 13, at pp 205-206: "The proposed legislation clearly is attempting to increase Government influence over the financial and policy direction, control and accountability of Crown corporations. This might be considered to be a logical event in light of embarrassing incidents with
The proposals as to accountability recommended by the Lambert Report have subsequently been largely implemented by federal legislation in Canada and appear to be functioning reasonably well in practice. The Canadian experience serves to illustrate that a structured legislative approach in this area can go some distance along the road to resolving many of the conceptual difficulties underlying public ownership.

3.2.3 Public Ownership in Australia

In Australia, public ownership also began at an early stage with the establishment of the Railway Commissioners as a statutory corporation in the State of Victoria in 1883 and there was a proliferation of further examples especially in the years prior to and immediately after the Second World War. During the 1980s this era of government ownership was succeeded by a move towards corporatisation and privatisation. This process was not as far reaching as in the United Kingdom and a programme of initial corporatisation of public enterprises proceeded more on a case by case basis than was the position in Britain, or in New Zealand. By the mid 1990s several of the Australian states had adopted legislation to facilitate these developments. It is interesting to note that many of the same considerations which concerned UK commentators, such as

Crown corporations in recent years. At the same time, there are contradictions. The Government indicates that it wishes Crown corporations to be independent so that they might attract entrepreneurially-minded management, yet it strictly controls chief executive salaries. It holds Crown corporations responsible for broader social goals while evaluating performance on commercial criteria. Commercial secrecy is to be preserved by a degree of independence, but the Government demands thorough reporting mechanisms and procedures, most of which enable the materials produced to be made public."

See the discussion in Prichard, supra note 9, at pp 76-80.


17. For a recent analysis of the legislation in force in the Australian states as of 1990 dealing with government owned corporations see Bottomley, "Some Issues Raised by Government Owned Companies" (1990) 8 Co & Sec LJ 257.
issues of accountability and the scope of control which could be exercised over these entities by administrative law, also arose in the Australian context.\(^{19}\)

The Australian Administrative Review Council has recently issued a report on the subject of government owned companies and their status in terms of federal administrative law\(^{20}\) and federal legislation is pending in terms of the Commonwealth Authorities and Companies Bill, introduced into the Australian federal Parliament in June 1994.\(^{21}\) The proposed legislation applies to federal statutory corporations and sets out various financial reporting obligations which such companies must observe. It also permits the responsible Minister to give general policy directions to the directors of the company.\(^{22}\) As in Canada, the adoption of more formal channels of accountability may hopefully serve to reduce concerns in this area in relation to government owned companies.

3.2.4 The New Zealand State-Owned Enterprises Act 1986

In New Zealand, the concept of the state owned enterprise was extensively utilised and a wide ranging programme of corporatisation and privatisation was undertaken during the 1980s. This followed an earlier period in which government ownership had

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19. A recent discussion of this area is contained in Batskos, "State-Owned Enterprises - Does Administrative Law Apply ?" (1994) 68 Law Inst J 839. For a more general treatment of these issues of corporate governance in Australia see McEwin, "Public Versus Shareholder Control of Directors" (1992) 10 Co & Sec LJ 182.


21. For a discussion of these recent developments see Bottomley, "New Legislation for Commonwealth Government-Owned Companies - Is it Sufficient?" (1995) 13 Co & Sec LJ 331. Little progress has been made with this Bill and as at July 1997 it was still on the Parliamentary Order paper. (See web site http://hansard.aph.gov.au/repsto/bills.htm.)

22. Much of the impetus for this legislation arose from investigations into widespread financial mismanagement in several Australian states during the 1980s, in particular in the state of Western Australia. There the state government became involved in a number of dubious (if not corrupt) financial ventures carried on through companies and other entities which it owned wholly or partly, giving rise to the uncomplimentary label "WA Inc". For a discussion of the background to these events see Western Australia Royal Commission, Report into Commercial Activities of Government and Other Matters (Government Printer, Perth, WA, 1992); Stone, "Accountability Reform in Australia: The WA Inc Royal Commission in Context" (1993) 65 Aust Qty 17; Stone, "Constitutional Design, Accountability and Western Australian Government: Thinking With and Against the 'WA Inc' Royal Commission" (1994) 24 UWAust LR 51.
followed more traditional lines. Thus, a Post Office Savings Bank had been established in New Zealand by legislation in 1865, a State Life Assurance Office in 1869 and a State Advances Department, which provided mortgage finance through a state agency, in 1894. In that year also the country's largest bank, the Bank of New Zealand, was rescued from insolvency by state intervention, beginning a lengthy period of government ownership which continued until the bank was sold into private hands in 1992.23 Similarly the State assumed responsibility for areas such as forest conservation from 1874 and hydro-electric development from 1928. Controlled marketing of primary products through a system of state agencies was introduced during the 1930s.

In the areas of railways and broadcasting considerable variation was evident in the forms of public ownership put in place earlier this century. Initially, railways in New Zealand were controlled through a government department and this continued until the establishment of a Railways Board in 1925. There was a reversion to departmental control in 1928 but a board structure was re-introduced during the 1930s. In the radio broadcasting field, a national broadcasting service under Board control was established in 1931. Radio, and later television, broadcasting was carried on under a Board structure in various forms until the late 1980s, although successive governments attempted to exert varying degrees of political influence on the Board.24

Prior to the restructuring of the public sector in New Zealand during the 1980s, which is described below, various forms of government enterprise existed. Some government commercial enterprise was conducted directly through government departments (with the Post Office, the Public Trust Office and the State Coal Mines being three significant examples.) In other cases, companies owned and managed by the state were incorporated under the ordinary companies legislation, prominent examples being Air New Zealand Limited and the New Zealand Synthetic Fuels Corporation Limited. Other government corporations were established under specific legislation, including the Tourist Hotel Corporation (1967), the Natural Gas Corporation (1967) and the


Offshore Mining Corporation (1972). In the area of primary produce the State played an active role through government agencies such as the New Zealand Dairy Board and the Kiwifruit Marketing Authority.25

A radical programme of state restructuring took place in New Zealand during the two terms of the Fourth Labour Government from 1984 to 1990. Despite its ostensibly socialist political philosophy, this administration introduced far-reaching changes in the structure of state trading activities and also in the areas of public administration, industrial relations and financial management. To a considerable extent these paralleled many of the policies of the Conservative Thatcher administration in the United Kingdom. It is not necessary for the purposes of this account to detail the economic and political basis for these policies (many of which were and still remain highly controversial in New Zealand) and this is a task which has been adequately performed by others.26

One of the most significant innovations was in the area of state ownership of industry. The form of state participation in industrial and commercial activities in New Zealand was fundamentally altered by the State Owned Enterprises Act 1986. This legislation introduced a new model of state enterprise which bore some passing resemblance to the concept of the post-war public corporation in the United Kingdom, but which was also fundamentally different in many respects. In adopting a wholesale change of this nature New Zealand took a different approach from the one which had been followed in

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26. The literature on these policies and their associated economic justifications (colloquially termed "Rogernomics" as the then Minister of Finance, Roger Douglas, was one of the main moving forces behind them) is extensive. Some of the leading accounts are Boston and Holland (eds), The Fourth Labour Government: Radical Politics in New Zealand (OUP, Auckland, 1987); Easton, The Making of Rogernomics (Auckland UP, Auckland, 1989); Bollard and Buckle (eds), Economic Liberalisation in New Zealand (Allen and Unwin, Wellington, 1987). For a dissenting view, arguing that the 'New Zealand experiment' has been implemented at too high a cost in terms of social and welfare goals, see Kelsey, The New Zealand Experiment: A world model for structural adjustment? (AUP/Bridget Williams Books, Auckland, 1995).
Australia, where the restructuring of public enterprise proceeded on a more selective and individualised basis.27

The 1986 Act sought to remodel the concept of public ownership in a number of ways. In terms of political accountability, it provided for the tabling in Parliament of half yearly and annual reports (including financial accounts), for an audit by the Audit Office, and for the application to state enterprises of the Official Information Act 1982 (NZ) and the powers of the Ombudsman. Section 4 of the Act, which is perhaps the central provision of the legislation, required each state enterprise to operate as a successful business as its principal objective, while also being a good employer and exhibiting a sense of social responsibility.28

The shares in SOEs were to be non-transferable and were held in trust for the State jointly by the Minister of Finance and the Minister primarily responsible for the particular enterprise. Directors could be appointed under section 5 of the Act and the Board of the SOE was accountable to the shareholding ministers. In turn those

27. For a description of the economic and political background to the establishment of state enterprises and the enactment of the State Owned Enterprises Act 1986 in New Zealand see Mascarenhas, "State-Owned Enterprises" in Boston, Martin, Pallot and Walsh (eds), Reshaping the State. New Zealand's Bureaucratic Revolution (OUP, Auckland, 1991), chapter 2.

28. It is useful setting out here the provisions of s 4(1) of the State Owned Enterprises Act 1986 (NZ) in full. This section provides as follows:

"4. Principal objective to be successful business - (1) The principal objective of every State enterprise shall be to operate as a successful business and, to this end, to be -

(a) As profitable and efficient as comparable businesses that are not owned by the Crown; and

(b) A good employer; and

(c) An organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so."

Similar provisions can be found in the Australian state legislation dealing with government-owned companies. In New South Wales, for example, s 8 of the State Owned Corporations Act 1989 sets out that it is one of the principal objectives of a NSW state owned corporation to "exhibit a sense of social responsibility." In this way governments have sought to achieve by statute corporate objectives which the common law has been unable or unwilling to impose on limited liability companies. See for example the discussion in Shenfield, Company Boards. Their responsibilities to shareholders, employees and the community (George Allen & Unwin, London, 1971); Lord Wedderburn of Charlton, "The Social Responsibility of Companies" (1985) 15 Melb ULR 4; Tolmie, "Corporate Social Responsibility" (1992) 15 UNSW LJ 268; Smith, "Three Faces of 'Corporate Social Responsibility': Three Sociological Approaches" in Sheikh and Rees (eds), Corporate Governance & Corporate Control (Cavendish Publishing, London, 1995), chapter 15.
ministers were made directly responsible to Parliament under section 6 for the performance of the SOE. Controls were imposed on share transfers and on the exercise of shareholders' powers (section 22). At the commencement of each financial year an SOE was required to deliver a draft statement of corporate intent to its shareholding ministers. Section 14 of the Act specified the contents of this statement in some detail, requiring it to cover the enterprise's corporate objectives, projected activities, financial position and budgeted performance targets.29

Section 7 of the 1986 Act was also significant and was intended to deal with the performance of non-commercial activities by an SOE. Where the Crown wished an SOE to provide any such services, the Crown and the enterprise were required to enter into an agreement under this section pursuant to which the Crown would reimburse the SOE for the whole or part of the price of those services. Finally, for present purposes, section 9 provided that nothing in the Act permitted the Crown to conduct itself in a manner inconsistent with the principles of the Treaty of Waitangi, which set out the rights of the indigenous Maori people.

Fourteen state enterprises were established under the 1986 Act, the leading examples being Air New Zealand Limited, Electricity Corporation of New Zealand Limited, New Zealand Railways Corporation, New Zealand Post Limited and Telecom Corporation of New Zealand Limited. As might be expected from such a comparatively radical legislative measure, the model proved to be controversial in practice. On the one hand, economists and commentators from the New Right have considered that the structures put in place by the Act have not gone far enough along the road to complete privatisation. On the other hand, as discussed below, other commentators have pointed to the potential contradictions of approach which may arise if the objectives in section 4 of the statute are to be conscientiously pursued by an SOE.

An example of the former viewpoint, favouring the private ownership model, can be found in the work of the New Zealand economists, Duncan and Bollard. Examples of the latter viewpoint are included in the discussion which follows.

3.2.5 Reconciling the Commercial and Social Objectives of State Owned Enterprises

The New Zealand legislation attempted to ensure that state owned enterprises would recognise both commercial and social objectives. Some commentators have expressed reservations about whether an SOE could adequately fulfil all of the roles required of it. Professor Taggart, for example, has pointed to the predominantly commercial nature of the SOE concept. He drew attention to the fact that during the period 1987-1990 the Government entered into only two reimbursement agreements under section 7, the first relating to a payment to New Zealand Post for the operating costs of some 600 post offices judged to be uneconomic during the first year following corporatisation and the second consisting of a similar payment to Post Bank in respect of the provision of mobile banking outlets.

It was no secret that the SOE concept was one which could readily lend itself to subsequent privatisation. This in fact represented the express policy of the New Zealand Treasury, which viewed the SOE structure as an interim stage along the road to

30. See Duncan and Bollard, *Corporatization and Privatization. Lessons from New Zealand* (OUP, Auckland, 1992), at p 181: "In crucial respects, however, some aspects of state enterprise management have been complicated by public ownership. There are numerous minor and several major examples of outside interference which would not have occurred under private ownership. More importantly, constraints have been imposed on managements and board which are unlikely to have applied in the case of private ownership. In particular, they have been locked into the particular inherited scope of operation but subject, at varying intervals, to the possibility of privatization. Such constraints would be atypical in the private sector."

31. Taggart, "Corporatisation, Privatisation and Public Law" (1991) 2 Public LR 77 at 78. This article contains a useful summary of the SOE structure in terms of the statutory provisions.

32. Ibid, at p 80: "Economists rightly point out that merely by imitating the corporate form, public enterprise will not be able to replicate the benefits of private enterprise. All of the monitoring mechanisms ... are less effective or non-existent in the SOE context. SOE shares are non-transferable, there is no share price and so takeovers are impossible. Nor is there a realistic prospect of insolvency. Moreover, while politicians can dismiss managers for unsatisfactory performance they are unlikely to do so."
fully privatised ownership.\textsuperscript{33} By 1992 several of the original SOEs had in fact been privatised in whole or in part, including Air New Zealand, Post Office Bank and Telecom. However, the difficulty of reconciling commercial and social objectives within the SOE framework has never really been adequately addressed and has been highlighted by the court decisions to date.

One recent illustration of this dichotomy has been the litigation between one SOE, Electricity Corporation of New Zealand Limited (Electricorp), and the Auckland Electric Power Board, which was subsequently restructured as Mercury Energy Limited (Mercury). In 1988 Electricorp and Mercury entered into an agreement for the supply of bulk electricity by Electricorp. This agreement was intended to be of a transitional nature pending negotiation of a longer term agreement but this later agreement had not been concluded by March 1992 when Electricorp gave the required 12 months notice to terminate the interim agreement. Mercury challenged the notice of termination on various grounds, one of which was that Electricorp had breached its obligations under section 4(1)(c) of the State Owned Enterprises Act 1986 by failing to exhibit a sense of social responsibility having regard to applicable community interests. The cause of action under the SOE Act was struck out by the High Court at first instance as being untenable in law.

On appeal, the New Zealand Court of Appeal upheld the judge's decision, holding that section 4(1) of the 1986 Act did not confer any justiciable rights on Mercury, as the concept of social responsibility in that section was not expressed in such a way as to lend itself to judicial assessment or determination.\textsuperscript{34}

\textsuperscript{33} This view was expressed in Government Management: Brief to the Incoming Government 1987 (New Zealand Treasury, 1987, Briefing Paper No. 1), pp 109-113. Such a perspective has certainly not been unanimous among political scientists and commentators. For a contrary opinion see Rosenberg, New Zealand can be Different and Better. Why Deregulation Does Not Work (NZ Monthly Review Society, Christchurch, 1993), chapter 10.

\textsuperscript{34} Auckland Electric Power Board v Electricity Corporation of New Zealand [1994] 1 NZLR 551 at 560 per Richardson J: "Section 4(1) does not confer a power in any true sense. It states the principal objective of an SOE. It is not directed to specific acts or omissions of an SOE, but with its overall performance. And all that in meeting the principal objective of operating as a successful business. Finally, paragraphs (a), (b) and (c) are not independent of one another. The answer to whether an SOE is satisfying s 4 does not rest on whether paragraph (c) is satisfied, let alone whether on one occasion an SOE acted in a manner which might prompt concern. Rather it turns on an assessment of whether, having regard to all the considerations referred to in s 4(1), the SOE is operating as a successful business. The balancing of social responsibility and profitability and that broad overall balancing are inherently unsuitable for judicial
This decision has been criticised by Professor Taggart as amounting to an abdication of judicial responsibility, ignoring the arguable intent of section 4(1)(c), which was to make consideration and implementation of social policies mandatory. A further appeal was subsequently brought to the Privy Council. While upholding the principle that SOEs were amenable to judicial review, both under the statutory review procedure contained in the Judicature Amendment Act 1972 (NZ) and also at common law, the Judicial Committee agreed with the Court of Appeal that the occasions on which such review would be successful were likely to be limited.

This reluctance on the part of the Privy Council to determine whether section 4(1) of the 1986 Act gave rise to mandatory considerations of social policy has been criticised by Professor Taggart, but clearly represents a judicial reticence to enter into areas which are perceived to be part of the responsibility of the legislature in setting economic policy. It also illustrates the fact that judges may sometimes be reluctant to make the assessment is appropriately made periodically through the accountability provided for in the statute. SOEs are accountable to ministers and through them to Parliament for meeting responsibilities reposed in them under the statute."

35. See Taggart, "State-Owned Enterprises and Social Responsibility: A Contradiction in Terms?" [1993] NZ Recent LR 343. At p 355 Taggart observes: "The Courts will not often intervene in SOE decision-making but that is no reason for the Court to retreat from the field altogether. If this minimal supervision of the statutory requirement that SOEs are to have regard to the interests of the relevant communities is considered too intrusive then I suggest the objection has less to do with non-justiciability and more to do with ideological preference."

36. Mercury Energy Limited v Electricity Corporation of New Zealand Limited [1994] 1 WLR 521 at 529 per Lord Templeman: "It does not seem likely that a decision by a state enterprise to enter into or determine a commercial contract to supply goods or services will ever be the subject of judicial review in the absence of fraud, corruption or bad faith. Increases in prices whether by state-owned or private monopolies or by powerful traders may be subjected to voluntary or common law or legislative control or may be uncontrolled. Where a state enterprise is concerned, the shareholding ministers may exercise powers to ensure directly or indirectly that there are no price increases which the ministers regard as excessive. ... Industrial disputes over prices and other related matters can only be solved by industry or by government interference and not by judicial interference in the absence of a breach of the law."


38. The Privy Council took a similar view of s 9 of the SOE Act, which provides that nothing in the Act permits the Crown to act inconsistently with the principles of the Treaty of Waitangi, in New Zealand Maori Council and Others v Attorney General of New Zealand and Others [1994] 1 WLR 254. Lord Woolf, in considering the extent of the obligation imposed on the Crown in right of New Zealand under s 9, expressed the view, at p 263, that the Crown could exercise a substantial degree of indirect control over the Broadcasting Corporation in relation to the promotion of Maori language television programmes by way of the setting of policy but that: "The purpose of section 9 is not, however, to provide a lever which can be used to compel the Crown to take positive action to fulfil its obligations under the Treaty. The section operates indirectly in relation to the issues in this case. It prevents the transfer of the assets when this would be inconsistent with the principles of the Treaty."
apply public law concepts such as judicial review to commercial decisions, a subject which will be discussed further in subsequent chapters.

These decisions illustrate the difficulty of combining commercial and social obligations on the part of state enterprises in an enforceable statutory framework which is amenable to judicial review on the basis that inadequate consideration has been given to promoting the required social obligations in any particular case. While the remedy of judicial review may be available in appropriate cases, as the Privy Council has confirmed, it is likely to prove very difficult, if not impossible, for a party seeking to challenge the social policy content of a decision to succeed in the absence of demonstrable bad faith, fraud, corruption or other similarly extenuating circumstances. There would accordingly seem to be little practical difference between the ability of an SOE and a fully privatised enterprise to pursue wholly commercial strategies without any appreciable risk of having such a course challenged through the mechanism of judicial review.

Whether or not this situation is desirable as a matter of principle, it is an outcome which probably accords with what the architects of the legislation, Douglas and others, intended when the concept of the SOE as a legal entity was created by statute. In some respects the philosophy underlying the SOE concept resembles that of the arms-length public corporation in the United Kingdom (although Roger Douglas and Herbert Morrison would be unlikely bedfellows in terms of their perceptions of the proper role of government, despite supposedly adhering to the same political tradition.)

Perhaps the essential difference between the two models is that the SOE was designed to be primarily a commercial enterprise with direct parliamentary accountability

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40. Roger Douglas, for his own part, made no secret of his view that state trading activities should have purely commercial objectives and should be carried on in an environment which was competitively neutral (the so-called "level playing field"). See Douglas, "R N Spann Memorial Oration to the Royal Australian Institute of Public Administration" (University of Sydney, 27 October 1987), pp 26-28; Douglas, "The Ends and the Means" in Walker (ed), Rogernomics. Reshaping New Zealand's Economy (GP Books, Auckland, 1990), chapter 2.
entrenched by statute. However, Morrison's concept of the public corporation was that of an entity which conducted public business, but which was intended to have a different aura from the typical capitalist enterprise, an ideal which was corrupted in practice by political interference and economic exigencies.

The New Zealand experience in this area suggests that, while there may be difficulties in reconciling the theory and practice behind imposing social obligations on corporatised public enterprises, attempting a fusion of commercial and social goals is a worthwhile exercise which could profitably be considered for adoption in other jurisdictions such as Britain. While merely providing for the observance of social goals in the enabling legislation may not automatically lead to the achievement of such objectives, it does serve to remind the management of state owned enterprises (and their critics) that they are required to have regard to factors other than solely commercial ones. As Martin reminds us in his critique of the privatisation movement, the goals of public enterprise are different.

3.2.6 Allocating Shares in Privatised Enterprises to the Public or to Consumers

Much of the criticism in the United Kingdom of the privatisation process has centred on the fact that upon privatisation the shares in firms which were previously publicly owned were allocated through the normal share market processes. The resulting objection that this required the people of Britain (or those who were in a position, or of

41. For a discussion of other forms of nationalised ownership which have been tried in Britain, including the use of 'mixed enterprises' and government shareholdings in privately owned companies, see Prosser, supra note 3, pp 30-34.

42. See Martin, supra note 4, at p 51, criticising the philosophy of New-Right supporters of privatisation such as Madsen Pirie of the Adam Smith Institute: "Yet rather than adjust his theory to the way in which capitalism actually works, Pirie appears determined to make the world conform to his fantasy. He seems to loathe the public sector precisely because it does not fit the mould, and he thinks it should... The point, however, is that the public sector is different. It can sometimes meet its social goals profitably, but its job is not to prioritize profit, and if it does so its social goals are often sacrificed. This is what Pirie and his fellow ideologists either do not understand or cannot accept." For similar sentiments see Wright, "A Critique of the Public Choice Theory Case for Privatization: Rhetoric and Reality" (1993) 25 Ottawa LR 1 at 37: "In a society in which wealth inequalities are ever-increasing and the political power of individuals is being undercut, public enterprises are important because they represent the continuing possibility that members of society will be able to have a say in the ends of social life. Public enterprises also serve to reinforce a sense of community and a more universal approach to social policy. ... universalism in public enterprises can form the basis of a more egalitarian society."
the inclination, to do so) to buy back their own family silver was canvassed in chapter 2.43 If a mechanism could be devised for allocating free of charge the shares in privatised enterprises to the public, or a defined section of it, perhaps making use of the trust concept, this might serve to reduce or eliminate the force of such criticisms. Indeed, from an historical perspective the legal concepts of the corporation and the trustee have always had a close affinity, as Max Weber and others have noted.44 The following analysis will focus on recent New Zealand experience with the use of the trust device in this way in the context of a restructuring of energy companies.

Prior to 1992 the domestic gas and electricity industries in New Zealand were administered through local electric power boards and gas companies. A widespread restructuring of both industries occurred in 1992 as a precursor to full privatisation. By the end of 1992 every local energy undertaking was required under the terms of the Energy Companies Act 1992 (NZ) to submit an establishment plan for a new energy company.45 Each such plan was required to contain the information specified in the legislation, including a share allocation plan setting out a scheme for allocating shares to constituent local authorities and to other classes of person in certain circumstances.46

The energy companies incorporated under the 1992 Act were required to operate as a successful business as their principal objective and to have regard to the desirability of

43. See the discussion in part 2.7 of chapter 2.

44. In his book, *Law in Economy and Society* (trans. Shils and Rheinstein, Simon and Schuster Publishing, New York, 1954), Weber noted at pp 178-179: "The structure of the corporation is not the only case in which English autocratic and institutional aspects have found expression. Alongside the corporation of the English type we find, as another substitute for the continental corporation, the technique of treating certain persons or bearers of office as trustees, i.e., persons to whom certain rights are entrusted for the benefit of either some certain beneficiary or beneficiaries or of the public at large. ...When English law did finally develop such a concept [that of the trust], the trust was continued to be applied to those institutions which could not be construed as corporations; but a similar trend has continued persistently to play an important role in the entire English law of corporations."


46. See Energy Companies Act 1992 (NZ), Part III. Section 18(2)(d) of the 1992 Act provides that an establishment plan under the Act is to, inter alia, "indicate whether or not any equity securities ... should be issued by the relevant energy company to any person consequent upon the vesting in the company of the relevant energy undertaking, and, if so, the name of the person and the kind, number, nominal value, and terms of those securities."
ensuring the efficient use of energy. Directors of the companies were to be appointed initially by the responsible Minister with former members of the local power boards being entitled to appointment in priority to other candidates.

The background to the New Zealand reforms extends back to 1986, when the then Labour government agreed in principle to deregulate the electricity industry and directed officials to carry out a review. A governmental task force was established in February 1988 consisting of representatives from the relevant government departments. This group produced a report in September 1989 which recommended that the monopoly position enjoyed by the existing electricity supply authorities should be removed and the authorities should be restructured in the form of independent companies which would be privatised and publicly listed. In 1989 the government established an Electricity Distribution Reform Unit (EDRU), which had the task of monitoring the process of corporatisation of the industry with a view to ensuring the success of the proposed restructuring. The EDRU published a report on the proposed reforms in March 1991.

That report summarised the proposed restructuring and discussed the possible legal structures for the new operating entities. The proposals included plans to vest the assets and liabilities of the existing supply authorities in limited liability companies whose shares would be beneficially held on behalf of the community by Electric Power Trusts. Some consideration was given to allocating shares directly to individual

47. Ibid s 36.
50. The EDRU report summarised the objectives of the reforms at p 3 in the following terms: "The government's objective in the reform of the electricity sector is to improve the efficiency of this substantial part of the economy for the ultimate benefit of the nation and energy users. The approach being used is to separate the contestable parts of the industry and remove barriers to competition so that they operate on a fully commercial basis. For the monopoly parts of the industry, light-handed regulation using yardstick comparisons based on full disclosure of prices and costs and recourse to the Commerce Act is proposed."
consumers or to residents of a particular community, but such a proposal was rejected as being logistically impractical and a trust mechanism was recommended.\footnote{51}{Ibid p 11, where the report noted: "Ultimate owners would not necessarily own shares directly in the operating company. It would be impractical, or at least costly for example, for the 'community' owner types to own shares directly in the EPC [Electric Power Companies]. The sheer magnitude of the numbers (at least a million, compared with current numbers of New Zealand shareholders in listed public companies of around half a million at most) and their transience, coupled with non share tradeability, would make share register administration alone a very large task. Such ownership tasks as appointing directors and providing them with clear signals of their intentions for the company would also prove difficult. The practical solution for these numerous and dispersed owners would be to focus their interests through a trust which would hold shares on their behalf. Trust objectives (which could range from specific to general community interest) and terms on which they would hold EPC shares would be recorded in the trust deeds."}

These recommendations were subsequently approved by the New Zealand Cabinet in late 1991. The restructuring Bill was introduced to Parliament in December 1991 and the legislation came into force progressively from 1 July 1992 to 1 April 1993. Initially the restructuring process was accompanied by a flurry of litigation, in which various parties sought judicial review of decisions approving various establishment plans for the proposed energy companies.\footnote{52}{For a reference to the relevant New Zealand cases see part 2.6.2 of chapter 2 and the accompanying footnotes. See also the recent case of Waitakere City Council v Waitemata Electricity Shareholders Society Inc [1996] 2 NZLR 735 where the local authority, Waitakere City Council, failed in its bid to prevent the shareholding vehicle, an incorporated society, from changing its rules to dilute the original control exercised by the Waitemata City over the activities of the society.} These actions were largely brought by local authorities, large commercial customers and consumer groups seeking to gain a strategic advantage from the share allocation procedures. Despite these initial challenges and the relative complexity of the legislative framework, the new regime shows considerable promise as a model for public ownership.

The successful adoption of techniques of this kind depends of course on a willingness at the political level to forego the fiscal advantages to the national treasury of a public share flotation in favour of a free share issue to trusts representing sections of the public or designated consumers. The underlying political gamble is presumably whether the political advantage generated among the recipients of the free share issue outweighs the political advantage which would be likely to result from a more general economic improvement brought about by the proceeds of a public share flotation flowing into the national treasury.
While such a balancing of political advantage might be possible in a smaller country such as New Zealand, which has relatively homogenous local interest groupings, the same considerations might not necessarily apply in Britain (or for that matter in federal jurisdictions such as the United States) where the external influences impinging on the political process are more complex and diverse. However, if privatisation is accompanied by an allocation of shares to the public free of charge then this might go a long way towards addressing the political and philosophical objections associated with the sale of assets which were previously publicly owned. As the New Zealand experience shows, the practical and logistical difficulties involved in allocating shares directly to eligible members of the public can be addressed by imaginative use of the trust concept, showing that public ownership can still prove to be a relatively flexible concept. This is one area of academic enquiry which has been only lightly touched on to date in the UK in particular and which could well merit further attention.53

3.2.7 Asserting Government Control through Shareholding Devices

Finally in relation to the question of public ownership as a means of control, some mention should be made of the ways in which existing corporate structures can be adapted to achieve this outcome. The fact that this is a topical issue is well illustrated by the use of the 'golden share' concept in the UK privatisation programme.54 This mechanism, whereby the government seeks to exercise some degree of residual control over undesirable takeovers and sales of shares in privatised companies, may be seen as representing something of a half-way house between full public and full private

53. UK commentators have recognised the possibility of privatising enterprises by methods other than public share flotations on the stock market. See for example Brittan, "The Politics and Economics of Privatisation" (1984) 55 Pol Qtly 109 at 123: "...privatisation which takes the form of handing over shares to all citizens without payment does help to make the distribution of capital assets less concentrated. If the Alliance parties were really radical they would seek to advance the debate in this direction, rather than to try to freeze the frontiers of state ownership." The Institute for Public Policy Research has recently advocated the adoption of mutualisation ownership structures for the operation of the Scottish water industry. See article in The Times, 22 September 1997: "IPPR calls for Scottish water co-ops".

ownership, although, as Professors Graham and Prosser have pointed out, for various reasons the UK experience with this device has left much to be desired. In Britain, the golden share device, involving a special share with strategic voting and other control rights entrenched in the company's articles of association, has been utilised in relation to various companies, including Rolls-Royce, Cable & Wireless, Jaguar, the British Airports Authority, British Telecom and British Gas (on their initial privatisation) and several water companies.

Despite its attendant difficulties the golden share concept has also been adopted in other jurisdictions. When New Zealand Telecom was privatised in September 1990 by the sale of its shares to a consortium consisting of two US telephone companies and two New Zealand-owned companies the government sought to exercise some residual control over the newly privatised entity by retaining a single "kiwi share" which had certain preferential rights. This mechanism was designed to enable the government to ensure the continued observance of the three principal conditions of privatisation, which were continued free local calls for residential customers, controls on increases in residential line rentals and the provision of a universal residential telephone service without price discrimination.

55. See Graham and Prosser, "Privatising Nationalised Industries: Constitutional Issues and New Legal Techniques" (1987) 50 Mod LR 16 at 36-38, where the authors note at p 38: "The competition of the market place is supposed to provide two great spurs to efficiency: fear of bankruptcy and fear of takeover. We have previously cast doubt on whether any government could afford to let some of these companies go bankrupt. We can now see that the special share replaces the 'market for corporate control' with the need to negotiate a takeover bid with government." See also Prosser, "Social Limits to privatisation", ibid, pp 219-220, who observes: "The golden share provisions have been of very little effect in the United Kingdom, partly because of their limited nature, partly because of bad drafting, but perhaps more fundamentally because their existence contradicts an important justification for privatisation in a United Kingdom context; that the market for corporate control, largely implemented through hostile takeovers, is a key mechanism for increasing enterprise efficiency." For a summary of the use of government shareholding in UK privatised industries see Fraser (ed), Privatization: The UK Experience and International Trends (Longman, Essex, 1988), chapter 3, entitled "Flotations". More recently, the Treasury has been busily engaged in selling the remaining government shares in utility companies and other privatised industries. See article in The Times, 4 December 1996: "Treasury in £257m utilities clearout"; National Audit Office Press Notice 17/97, 27 February 1997, Sales of the Government's Residual Shareholdings in BP, BAA and in Other Privatised Companies (copy on the internet at web site http://www.open.gov.uk/nao/pn.htm), referring to Audit Office report of that title, HC265 1996/97, setting out the National Audit Office's findings in relation to whether government strategy for sales of shares in privatised industries provided value for the taxpayer (and concluding that they did).

56. See Graham and Prosser, Privatising Public Enterprises, supra note 54, pp 141-143.

57. For a critical description of these arrangements see Taggart, supra note 31, pp 98-101, who casts doubt on the practical enforceability of the conditions of privatisation of Telecom New Zealand. Other critics...
The use of shareholding devices of this kind illustrates the sensitivity which governments have to allowing newly privatised enterprises free rein to pursue their own corporate objectives free from any form of continuing government control. However, the efficacy of these methods may be open to doubt, as the above discussion shows.

3.3 Regulatory Control Through Appointment of Directors

3.3.1 The Use of Nominee or Independent Directors as a Control Technique

Another area in which government regulatory objectives have been pursued through the use of aspects of the corporate structure is in relation to the appointment of nominee or independent directors to the boards of privately owned companies. If a government-appointed director could be installed on a board and used as a conduit for making government policy known to the board and perhaps influencing its deliberations then some degree of indirect government control might be able to be exerted over a company's affairs.

Indeed, the use of such a mechanism need not be restricted to government appointees. If other interest groups, such as employees, management or consumers, were able to secure the appointment of a sympathetic nominee director to the board of a privately owned enterprise then the wishes of the appointor might similarly be able to be made known through this means. The appointment of an independent director, while possibly lacking the same cogency as a nominee, might also lead to a similar result.

To begin with the appointment of nominee directors, there is nothing inherently novel about the idea of making use of a nominee or representative director to advance the position of particular interest groups at board level. Harold Laski, in his leading work on the political structure of Britain published in 1925, envisaged that the boards of nationalised industries to be formed at some future time would be representative of

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different interests. Laski advanced a remarkably far-sighted view of the ideal board structure for such industries.\textsuperscript{59}

From a comparatively early stage the potential for using nominee directors to represent sectional interests in a unified corporate structure was therefore recognised, beginning a long tradition of collectivist thought in this area which is still reflected in current Labour party policy.\textsuperscript{60} Unfortunately at this point innovative techniques begin to come into collision with accepted company law theory. As commentators such as Baldwin have noted, attempts to influence policy at board level in this way face considerable theoretical obstacles.\textsuperscript{61}

This issue did not arise directly in the context of the public corporations, which were not incorporated under the Companies Act and which had a governing board comprised of various appointed members rather than directors as such. However a government-

\textsuperscript{59}Ibid p 445: "At the apex of each national industry will be a governing board in which there will be vested the full power to carry out the policy approved by the legislative assembly... It will need to represent three different types of interest in the industry. There will be members who represent the side of management, in which the technical side is included; others, again, will represent the different vocations, both manual and clerical; others, finally, will represent the public, and especially those industries which are allied to the service concerned."

\textsuperscript{60}See for example the speech by the then Shadow Chancellor, Mr Gordon Brown, on 1 May 1995 unveiling various corporate governance proposals, including "encouraging institutional investors to participate and vote at annual general meetings on the composition of boards and the appointment of non-executive directors." See article in the \textit{Financial Times}, 2 May 1995: "Blair warned on pace of reforms." For an earlier treatment of these issues see Shenfield, \textit{supra} note 28. Continental systems of company law and administration, such as that of Germany, have long prescribed representative systems of corporate governance. See for example Reading, \textit{The Fourth Reich} (Weidenfeld & Nicolson, London, 1995), p 147: "German companies operate for the benefit of their 'stakeholders', all of whom have an interest in the company's survival and success. In addition to shareholders, stakeholders include employees, unions, bankers, customers and suppliers. The determination of what is in their collective best interests is formalised through the system of supervisory boards, which all large companies must have. One third of the seats on these boards (one half in the iron and steel industry) go to workers' representatives. Thanks to cross shareholdings, customers and suppliers are usually represented, as are the company's bankers."

\textsuperscript{61}Baldwin, \textit{Regulation in Question: The Growing Agenda} (Merck Sharp & Dohme publication, London, June 1995), pp 119-120: "The Government now owns special shares in BT, British Gas, National Grid, National Power and Powergen and special shares in the regional water and electricity companies expired in March 1995. Accountability, some may say, can be strengthened by using such share ownership to appoint a director and exert influence at board level. The aim would be to ensure that the utilities serve public rather than private interests. Governmentally-appointed directors have to date, however, only played a limited role in regulated companies' operations. The core problem is that present company law restricts the power of a director to act other than in the interests of the company as a whole. Until the legal position is clearly amended, the share system is perhaps best viewed as, at most, a potential means to provide governments with information concerning the utility companies' operations."
appointed director of a limited company which was subject to the Companies legislation would be obliged to treat board papers and matters discussed at board meetings as being confidential, even from the Minister responsible for the government department from which the nominee director was appointed, in a case where the appointed director was also a civil servant.

The perceived limitations imposed by company law on the ability of nominee directors to represent the interests of their appointors merit some further examination here as legal opinion on this subject, both academic and judicial, is not unanimous. In terms of traditional doctrine, the office of a company director has been conceived of as being personal to the incumbent, so that in exercising his or her powers as a director the appointee must not act as the servant or agent of any external party. Even if the nominee director is in fact an employee of the appointing party (or is a civil servant, in the case of a nominee director appointed by the government) the principle continues to apply. While a director nominated by a particular shareholder or other outside party may owe certain obligations of loyalty to that party, perhaps arising out of the employer/employee relationship, traditional company law theory requires that such duties must be subordinated, in the event of conflict, to the director's primary duties of loyalty and good faith which are owed to the company.62

62. For examples of cases which have upheld this traditional approach see Scottish Cooperative Wholesale Society v Meyer [1959] AC 324 at 366-367 where Lord Denning MR observed: "So long as the interests of all concerned were in harmony, there was no difficulty. The nominee directors could do their duty by both companies without embarrassment. But, so soon as the interests of the two companies were in conflict, the nominee directors were placed in an impossible position ... They probably thought that 'as nominees' of the co-operative society their first duty was to the co-operative society. In this they were wrong."; Boulting v Association of Cinematograph, Television & Allied Technicians [1963] 2 QB 606 at 626-627, where Lord Denning MR observed: "Or take a nominee director, that is, a director of a company who is nominated by a large shareholder to represent his interests. There is nothing wrong in it. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the interests of the company which he serves." For examples of Australian cases to similar effect see Fowles v Eastern & Australian Steam Ship Co Ltd [1916] 2 AC 556 (PC); Bennetts v Board of Fire Commissioners of NSW (1967) 87 WN (NSW) 307; Oceanic Crest Shipping Co v Pilbara Harbour Services Pty Ltd (1986) 160 CLR 626. For a discussion of these authorities see Crutchfield, "Nominee Directors: The Law and Commercial Reality" (1992) 20 Aust BLR 109. Such obligations may also be owed by directors of corporations which are incorporated by statute rather than under the Companies legislation. See for example the recent Australian case of State of South Australia v Marcus Clark (1995-96) 19 ACSR 606, in which the Supreme Court of South Australia held that a director of the State Bank of South Australia, a body incorporated by statute and not under the Companies Act, nevertheless owed fiduciary duties to the bank in the same way as if the bank had been a limited company.
This traditional approach was recently affirmed by the Privy Council in 1990 on an appeal from the Court of Appeal of New Zealand, in which the Judicial Committee affirmed that directors of a company act as agents of the company and not of any third parties. In the normal course of events the company, as the principal, is liable for the acts of the directors as its agents. In that case a bank which had appointed two nominee directors, who were employed by the bank, to the board of a company in which it held a significant shareholding was held not to be vicariously liable for the alleged negligent acts of those employees in the course of their duties as directors.63

Despite such firm expressions of principle, other judges and authors have pointed to the practical difficulties which arise from disregarding the commercial reality of the relationship between nominee directors and their appointors.64 Sievers, for example, has pointed out that directors appointed by virtue of their position as employees of the appointor may face an impossible conflict between their primary fiduciary duty to the company and duties arising out of their relationship with the appointor.65

In two Australian cases decided in the 1960s the court expressed the view that the scope of a director's fiduciary duty to a company might be modified by external circumstances and the wishes of the appointing party,66 although more recent Australian cases have tended to adopt a less accommodating attitude to conflicts of

63. See *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187. (The writer confesses here that a good deal of his familiarity with this line of authority arose from being junior counsel for the respondent in this Privy Council appeal, unfortunately on the losing side!) Lord Lowry, delivering the advice of the Board, observed at p 222, in relation to the responsibilities of the two nominee directors, House and August, who had been appointed by the bank: "In the performance of their duties as directors and in the performance of their duties imposed by the trust deed, House and August were bound to ignore the interests and wishes of their employer, the Bank. They could not plead any instruction from the Bank as an excuse for breach of their duties to AICS [the company of which they were directors] and NMLN [the trustee under the corporate trust deed of AICS]. Of course, if the Bank exploited its position as employers of House and August to obtain an improper advantage for the Bank or to cause harm to NMLN then the Bank would be liable for its own misconduct but there is no suggestion that the Bank behaved with impropriety. Its duty to refrain from exploiting its influence over its employees is no different in principle from the duty of a father not to exploit his influence over a son who is a director or the duty of a businessman not to exploit his influence over a business associate who is a director."

64. In this context one might recall the observation of Lord Wilberforce (given in the context of another Privy Council appeal from New Zealand) that the common law should adopt a practical approach according with commercial reality. (*See New Zealand Shipping Co Ltd v A M Satterthwaite & Co Ltd* [1975] AC 154 at 167.)


interest involving nominee directors. Several recent New Zealand decisions in this area have tended to cast doubt on whether the strict position in relation to nominee directors continues to be appropriate under modern commercial circumstances.

In the United States, the fiduciary duties owed by a director to a corporation have been the subject of further refinement in the case law. US analysis has tended to focus on the fairness of the particular transaction in which allegations of conflict of interest involving nominee directors have been raised. In Canada, the courts have tended to take a stricter view in relation to nominee directors' conflicts of interest, along the lines of the approach of the more recent Australian authorities. One of the difficulties confronting the adherents of a more liberal approach in this area has been the well documented corporate excesses of the past decade, which were unfortunately often either accompanied or facilitated by blatant conflicts of interest at board level. The utility of the nominee concept in promoting sectional interests at board level has therefore tended to be tarred with more sinister brushes, such as insider trading, creative accounting and sheer fraud and embezzlement, often committed by apparently leading lights in the corporate world.


68. See Berlei Hestia (NZ) Ltd v Fernyhough [1980] 2 NZLR 150; Trounce and Wakefield v NCF Kaiapoi Ltd (1985) 2 NZCLC 99,422; Dairy Containers Ltd v NZI Bank Ltd [1995] 2 NZLR 30, in which Thomas J noted at p 96: "On the basis of these decisions, nominee directors need not necessarily approach company problems with an open mind and they may pursue their appointor's interests provided that, in the event of a conflict, they prefer the interests of the company. In such circumstances the breadth of the fiduciary duty has been narrowed by agreement amongst the body of shareholders. In other words, the corporators have agreed upon an adjusted form of fiduciary obligation." For commentaries on the Dairy Containers decision see Baxt, "Can nominating companies be vicariously liable for the negligence of their nominee directors?" (1995) 69 ALJ 684; Russell, "Nominee Directors - The Dairy Containers case" [1995] Co & Sec L Bulletin 23; Campbell, "Directors' Liability: Casting A Long Shadow" [1996] Co & Sec L Bulletin 10; Pizer, "Holding an Appointor Vicariously Liable for its Nominee Director's Wrongdoing - an Australian Roadmap" (1997) 15 Co & Sec LJ 81.

69. For some representative US cases in this area see Globe Woollen Co v Utica Gas and Electric Co 121 NE 378 (1918); Geddes v Anaconda Copper Mining Co 254 US 590 (1920); Sinclair Oil Corporation v Levien 280 A 2d 717 (1971); Weinberger v UOP Inc 457 A 2d 717 (1971).

70. See Canadian Aero Services Ltd v O'Malley (1973) 40 DLR (3d) 371; Abbey Glen Property Corporation v Stumborg (1976) 65 DLR (3d) 235; Redekop v Robco Construction Ltd (1978) 89 DLR (3d) 507.
3.3.2 The Scope for Possible Legislative Reform.

In this area of the law, as in many others, legal doctrine is forced to cater for abuses at the level of the lowest common denominator and often lacks the flexibility to recognise genuine applications of an innovative principle. Put more basically, the innocent have to suffer along with the guilty. There are recent signs that various jurisdictions have attempted to remedy this situation through legislation. In the United States, several state jurisdictions have passed statutes which expressly distinguish between situations involving directors with a financial interest in a particular transaction and those where the corporations involved merely have common directors with no independent financial interest. There have also been some suggestions in the literature that directors of US government-owned corporations may be in a different position, in terms of possible personal liability, from directors of private corporations. In Canada, the Province of Alberta has incorporated a provision in its Business Corporations Act which recognises that a nominee director may give "special, but not exclusive" consideration to his or her appointor's interests in the course of carrying out duties as a director.

Similar reforms have been suggested in Australia by the Companies and Securities Law Review Committee but no legislative action has yet been taken on these recommendations. In New Zealand, the recent 1993 Companies Act allows

71. US states which have adopted such statutes include California, Connecticut, Maine and South Carolina. See for example California General Corporation Law, § 310.

72. See for example Thurston, Government Proprietary Corporations in the English-Speaking Countries (Harv UP, Cambridge, Mass, 1937), whose views on the management of government owned corporations contrast with those of the British commentators of the same period such as Herbert Morrison and Harold Laski (see part 2.6.1 of chapter 2 and note 58, supra). At p 160 for example Thurston notes in relation to the position of the directors of publicly owned companies: "The directors should not be representatives of particular interests but trustees of the public interest. There is a place for the representation of interests, but it is not on the board of directors, for the function of the directors is essentially to weigh the claims of different groups and take such action as will prove of the greatest benefit to the country as a whole." See also Wirtz, "The Legal Framework of the Tennessee Valley Authority" (1976) 43 Tenn LR 573; Hobbs, "Personal Liability of Directors of Federal Government Corporations" (1980) 30 Case Western LR 733.

73. See Alberta Business Corporations Act, s 117(4) which provides: "In determining whether a particular transaction or course of action is in the best interests of the corporation, a director, if he is elected or appointed by the holders of a class or series of shares or by employees or creditors or a class of employees or creditors, may give special, but not exclusive, consideration to the interests of those who elected or appointed him."

74. Baxt, supra note 68, notes at p 686 on this subject: "That view of course is not part of Australian law yet, although it is an approach that perhaps the Australian legislatures should adopt."
additional flexibility to a director of a company which is itself a wholly owned subsidiary,\textsuperscript{75} permitting such a director to act in the best interests of the holding company. This covers the situation of an appointor which holds a controlling interest in the company on whose board the director sits, although it does not extend to appointors which do not hold such an interest. It would therefore not normally extend, for example, to an appointor which is a trade union, a consumers' organisation or other form of third party interest group that is seeking to appoint a nominee director.\textsuperscript{76}

In New Zealand the issue of the conflicting responsibilities of company directors has surfaced at the practical level in relation to the trading activities of local authorities. Since 1989 local authorities in New Zealand have been permitted to carry on commercial trading activities through incorporated companies.\textsuperscript{77} Local Authority Trading Enterprises (known by the acronym as LATEs) were incorporated by a number of New Zealand local authorities and their directors often consisted of local authority representatives, such as councillors. This practice was the subject of investigation and report by the New Zealand Auditor General following concerns that councillors in this position were often faced with a conflict of interest between their duties as directors of a commercial enterprise and their duties to the local authority to which they had been elected.

In his report of June 1994 the Auditor-General noted that there was a clear potential for such conflict situations to arise\textsuperscript{78} and recommended that local authorities should clearly

\textsuperscript{75} See Companies Act 1993 (NZ), s 131(2) which provides that: "A director of a company that is a wholly-owned subsidiary may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of that company's holding company, even though it may not be in the best interests of the company."

\textsuperscript{76} There is no comparable provision in the UK Companies legislation, although s 309(1) of the Companies Act 1985 allows directors to have regard to the interests of the company's employees as well as its members.

\textsuperscript{77} For a discussion of the relevant legislation, contained in the Local Government Amendment Act 1988 (NZ) and experience with its operation to 1993 see Palmer, \textit{supra} note 45, pp 679-683.

\textsuperscript{78} See \textit{Report of the Controller and Auditor-General on Governance of Local Authority Trading Activities} (Audit Office, Wellington, 1 June 1994) at paras 319-321:

"319 Many nominee directors viewed themselves as a monitoring link between the company and the council, and as a means of assessing the performance of the other directors. In many cases, we were told that information about the company was given informally to the council whenever the nominee director considered that there were impending issues of which the council should be aware.
specify the lines of demarcation between councillors and directors of trading enterprises so as to avoid conflicts of interest occurring.79 Such proposals are a welcome attempt to address this problem. Whether they will be observed by local authorities remains to be seen. The temptation to divulge details of the council's commercial activities to a receptive audience at council meetings must be a strong one and may possibly prove to be irresistible in practice.

In the UK there has been periodic discussion both academically80 and at government level81 on the use of government appointed nominee directors as an avenue of government control in relation to companies in which public funds have been invested. In its 1985 report on the subject the Public Accounts Committee noted the ambivalent legal position of nominee directors82 and recommended that expanded guidance in

320 Where nominee directors acted in a monitoring role, the reporting process from the nominee directors to the council was not authorised by the board; nor were other directors aware of what company matters might be communicated to the council, or how that information might be used. This arrangement risks undermining the unity of the board. It also exposes councillor directors to a conflict between their duties to the company and their interests as representatives of the shareholder body.

321 It is equally important for chief executives to separate their dual interests where they are also acting as directors of council companies."

79. Ibid paras 326-327:

"326 Elected representatives appointed to a board of directors have a primary responsibility to the company which they should not confuse with their role as councillors. Local authorities should specify the role and responsibilities of elected representative directors to boards in order to make this distinction clear. Nominee directors should not be seen as a substitute for a formal monitoring arrangement between the council company and the shareholding local authority.

327 Chief executives should not be put in a position of conflict between their roles as advisors to the council and their obligations as company directors."

80. See Graham and Prosser, supra note 55 at pp 34-36, who note the potential for conflict between government nominated directors appointed for the purpose of exerting corporate control and company law theory in the following terms at p 36: "Company law treats companies as groups of individuals who have invested in a profit-making enterprise which is carried on owing few duties to outside interests. Thus the implication is that in order for public directors to be effective, company law needs to take on board a wider view of the groups that have a legitimate interest in the company's performance. In the absence of this, government directors are no more than window dressing or a channel for communications that would have taken place anyway." See also Prosser, supra note 3, p 33.


82. See First Report, ibid, paragraph 30: "Although, in most instances, a nominee director acting for his sponsor body would also be acting in the interests of the company's investors generally, the present position in law appears possibly to prevent such a director from carrying out the monitoring duties which we would expect him to discharge. Thus we see it as a matter for concern that nominee directors, because
respect of government-appointed nominee directors should be introduced. The Treasury agreed that the guidance then in force should be expanded in terms of the Committee's recommendations, but considered that the area was one in which it was difficult to generalise, given the variety of circumstances in which the appointment of nominee directors might arise.

Parkinson, in his comprehensive recent study of the theory of corporate power and control, has studied the potential for using the nominee director concept as a representative device, both in the United Kingdom and in the United States. He has noted existing attempts to alter the composition of company boards by appointing either nominee or independent directors to represent interests such as employees, consumers, proponents of environmental protection and the local community. Part of the difficulty with such proposals has been the lack of legislative principles to guide the conduct of such directors.

There is little incentive for privately owned (or privatised) companies to appoint nominee or independent directors voluntarily in the absence of any legislative

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83. **Ibid**, paragraph 34: "We also consider that the guidance [issued by HM Treasury] should be amplified to make clearer what the nominee directors are expected to do." (The Committee went on in paragraphs 34 and 35 of its Report to set out detailed areas of company monitoring which the guidance ought to cover.)

84. See the **Treasury Minute, supra** note 81, paragraph 5, in which the Treasury accepted that the guidance for nominee directors should be expanded in terms of the Report of the Public Accounts Committee and observed: "It is the intention that the guidance will provide a common but flexible basis which departments and NDPBs can use to provide guidance appropriate to the circumstances of the appointment of each of their nominee directors."

85. **Ibid**, paragraph 6, in which the Treasury noted: "In the view of the Treasury it is difficult to reach general conclusions about the effectiveness of nominee directors, which has to be considered case by case. The Treasury has asked departments and NDPBs to review periodically the effectiveness of each appointment and advise the Treasury when particular arrangements have been notably effective or ineffective."


87. **Ibid** p 389: "A major difficulty with this approach, however, is that if independent directors are to have a significant impact on company behaviour a set of relatively concrete substantive principles to guide their conduct seems to be required. The rationalization of social responsibility as a process concept is appropriate for purposes of analysis, but at the level of implementation, in the absence of such principles, it seems unlikely that independent directors will be capable of the coherent action necessary to deflect management from conventionally self-interested policies."
compulsion. The legal difficulties identified above, even if they are not insuperable, do tend to provide a substantial disincentive to using board appointments as a method of asserting external regulatory control. There have been isolated instances in the United Kingdom where the appointment of an independent director has been advocated in a regulatory context. One recent example was the orchestrated attempt during 1994 to appoint an independent director to the board of Yorkshire Water in order to improve the company's responsiveness to consumer dissatisfaction.\textsuperscript{88}

In the United States context, periodic suggestions have been made advocating the appointment of nominee or independent directors by shareholders and outside interests as a control mechanism. However, there is little evidence that the concept of external appointments is any more popular (or any less devoid of legal fishhooks) on the other side of the Atlantic than in Britain.\textsuperscript{89} All of the above difficulties suggest that more extensive use of these techniques is therefore unlikely under the present legislative framework governing company law. This is unfortunate as an effective mechanism for

\textsuperscript{88} For references to the Yorkshire Water example see MacDougall, "Corporate governance issues" in Corry (ed), Profiting from the Utilities: New Thinking on Regulatory Reform (IPPR, London, 1995), p 73; article by Simon Davis in the Financial Times, 30 September 1994, "Watchdog fails to join Yorkshire Water board", recording that Mrs Diana Scott, the former chairman of the OFWAT Yorkshire Region Customer Service Committee, had attracted strong support for her proposal to be appointed to the company's board from individual shareholders on a show of hands at the company's 1994 AGM held on 29 September 1994 but had been outvoted on a poll by institutional shareholders, voting by proxy, by 62.3m shares voting against and 16.5m in favour. In July 1996 Mrs Scott again sought appointment as chairman of the board in place of the company's own candidate, Brandon Gough, on the basis that Mr Gough was unable to devote sufficient time to the company's affairs, but was again outvoted. See article in The Times, 17 July 1996: "Yorkshire Water investors urged to oppose new chief."

\textsuperscript{89} For a selection of US periodical articles dealing with the American approach in this area see Schwartz, "Governmentally appointed directors in a private corporation - the Communications Satellite Act of 1962" (1965) 79 Harv LR 350, where the author concludes at pp 363-364: "Both the practicalities of life and the lessons of history lead to the conclusion that the appointment of government directors to a private board cannot effectively protect the public interest against private abuse. Moreover, such directors may even be instruments of harm to other aspects of the public interest ... There is no doubt that imaginative structures for government-industry cooperation are necessary, but the use of government appointees on a private board seems neither particularly imaginative nor efficacious."; Brudney, "The Independent Director - Heavenly City or Potemkin Village?" (1982) 95 Harv LR 597, where the author summarises his view of the issue at p 658 in the following terms: "But neither theory nor practice permits the conclusion that the independent director can be as successful a monitor of social responsibility as it is claimed he is, or even as he may be, as a monitor of integrity."; Black, "Shareholder passivity re-examined" (1991) 89 Mich LR 520, in which the author notes that shareholders are deterred from playing an active role on issues of corporate governance by the complexity of the legal position and the risk of becoming involved in intractable conflicts of interest; Gilson and Kraakman, "Reinventing the outside director: an agenda for institutional investors" (1991) 43 Stan LR 863, where the authors advocate that institutional investors should use their voting power to elect suitably qualified independent directors onto company boards in order to influence corporate policy.
airing third party viewpoints at board level might conceivably lead to a reduction in the level of misunderstanding and antagonism which currently surround the activities of many privatised enterprises.

3.3.3 Difficulties Posed by the Shadow Director Concept

Another potential legal impediment to the appointment of individual directors to represent sectional interests on the boards of companies derives from the concept of the "shadow director". This is a legal fiction developed by company law theory to provide a means of controlling de facto directors who might exercise the real power of a corporate board while sheltering behind members of the board whom they control and who are effectively their puppets.90

Most modern company law statutes define the term "director" widely, so as to cover parties who exercise 'behind the scenes' control of a board of directors, or who are in a position to direct the decisions of the board.91 Parties appointing nominee directors may well be at risk of incurring liability as shadow directors within the terms of such extended statutory definitions. Potential appointors of nominee directors therefore face a dual difficulty. First, their nominee may be personally liable in the event of a conflict of interest or a breach of fiduciary duty and the nominator may in turn incur consequent liability for the acts of the nominee. This will especially be the case where, as is often the position, the nominated director has an enforceable indemnity from the nominating party. There is also the possibility of an action in tort against the nominating party,

90. Judicial awareness of the existence of such background influences has become more pronounced in recent years, one prominent example being the judgment of Lord Denning MR in Wallersteiner v Moir [1974] 1 WLR 991 at 1013: "Even so, I am quite clear that they were just the puppets of Dr Wallersteiner. He controlled their every movement. Each danced to his bidding. He pulled the strings. No-one else got within reach of them. Transformed into legal language, they were his agents to do as he commanded."

91. In England, s 741(2) of the Companies Act 1985 defines the expression "shadow director" as meaning: "...a person in accordance with whose directions or instructions the directors of the company are accustomed to act." The term itself was first used in s 63 of the Companies Act 1980, although legislative recognition of the concept in British Companies legislation extends as far back as 1917. For the relevant legislative background see Girvin, "Statutory liability of shadow directors" [1995] Jur Rev 414 at 414-416. Similar legislation is in force in most Commonwealth jurisdictions, examples being the Australian Corporations Law, s 60(1)(b) and the Companies Act 1993 (NZ), s 126(1). For a recent judicial discussion of the concept of a shadow director under the UK legislation see Re Hydrodan (Corby) Ltd [1994] BCC 161.
under which the claimant may seek to hold the appointor vicariously liable for the acts of the nominee, although the legal basis for such a tortious claim remains doubtful.\textsuperscript{92}

Secondly, the appointing party may find that it incurs statutory liability in its own right if it falls within the legal definition of a "shadow director" under the Companies Act. This is often a particular concern for banks, who may seek to appoint suitably qualified nominees as directors of a failing company to try and nurse the company back to health rather than embark on the more drastic course of appointing a receiver. Recent authorities have illustrated that such a course may be a dangerous one, given that if the appointor seeks to dictate company policy through the appointed directors it will almost inevitably bring itself within the statutory definition of "shadow director".\textsuperscript{93} However at the same time, the appointor will be unable to benefit from the statutory protection accorded to receivers appointed under a debenture, who are usually made the agent of the company rather than the debenture holder under the terms of most modern debentures and Companies Acts.\textsuperscript{94}

These difficulties afford another reason why external interests may prove to be understandably reluctant to appoint a representative or nominee director. Even a single nominee director, or a minority of nominee directors on a board, may render their appointor liable in its own right as a shadow director if those directors exert a dominant

\textsuperscript{92} The Privy Council in the \textit{Kuwait Asia Bank} case, \textit{supra} note 63, cast doubt on whether an action in tort against the nominator was maintainable in such circumstances. However, other recent cases, such as the New Zealand decision in \textit{Dairy Containers}, \textit{supra} note 68, have held that there is no reason in principle why a nominating party should not be vicariously liable for the negligent acts of a nominated director in appropriate circumstances, especially where the nominator had either interfered in the company's affairs or played an active role in its management. As Thomas J noted in that case at p 97: "The desirability of re-examining the Privy Council's finding in Kuwait case is illustrated by the facts of this case. NZDB appointed three of its senior executives to act as directors of its wholly-owned subsidiary, DCL. It expected them to protect and promote the Dairy Board's interests ... If the legislature in New Zealand had permitted a corporate body to be a director of a company, NZDB could itself have been a director of DCL. As such, it would have owed a duty of care to that company. In principle, it should make no difference that NZDB was represented by its employees."


\textsuperscript{94} See for example the Companies Act 1985, s 473(1): "A receiver is deemed to be the agent of the company in relation to such property of the company as is attached by the floating charge by virtue of which he was appointed."
influence in relation to board decisions, so that the board as a whole is accustomed to act in accordance with their instructions.\textsuperscript{95}

The above legal difficulties, which affect both the nominator and the nominee in relation to board appointments made for the purpose of reflecting sectional interests and influencing company policy, illustrate why the use of existing corporate mechanisms as a means of asserting external regulatory control have been of limited popularity. As the discussion in this part of the chapter has shown, the law in this area has been more concerned with controlling the adverse effects of potential conflicts of interest at board level than with promoting the possible regulatory benefits of external intervention in a company's affairs. These existing legal impediments seem unlikely to alter in the foreseeable future. Attention therefore needs to be focused on methods of securing regulatory effectiveness independently of the corporate structure of the regulated firms.

3.4 Summary

The theory of regulatory intervention to be advanced in chapter 5 emphasises the role of structured mechanisms, including consultation and participation, as a means of reconciling differing interests in regulatory outcomes. Forms of public ownership have the potential to provide such a structure, albeit by directing rather than facilitating outcomes in any particular case. However the analysis in this chapter has shown that there are a number of difficulties which characteristically arise in practice in the course of trying to fulfill such a goal, leaving aside the perennial debate about comparative commercial efficiency. These include:

- An overriding temptation for governments to use publicly owned enterprises for the achievement of short term political goals, at the expense of sound long term policies;

\textsuperscript{95} Under some statutory provisions, such as the Companies Act 1993 (NZ), s 126(1)(b)(i), an appointing party can qualify as a shadow director even if that party directs or instructs only one of the directors on the board. For an illustration from a recent Australian case of a shadow director which only appointed three out of nine directors, but where the board of directors as a whole tended to comply with the directions of those three nominees, see \textit{Standard Chartered Bank of Australia Ltd v Antico} (1995) 131
• The possibility (and often the actuality) of political interference in the commercial decisions of such enterprises;

• The fact that publicly owned enterprises are not necessarily supportive of or responsive to consumer interests;

• Channels of accountability which may be blurred (or covert in terms of their operation);

• Overly optimistic legislative aims directed at promoting both commercial and social objectives (a possible objection to the New Zealand legislation governing state owned enterprises.)

However the discussion in this chapter has also highlighted the fact that there are more innovative forms of public ownership which have greater potential as a mechanism for reconciling conflicting interests in regulatory outcomes:

• The allocation of shares in privatised companies to consumers or to sections of the public either gratuitously or through the use of vehicles such as consumer trusts;

• Innovative use of the ‘golden share’ concept, allowing for the imposition of regulatory goals through government shareholding carrying certain entrenched rights;

• The use of nominee or independent directors as a means of influencing corporate policy at board level and making companies more responsive to the needs of third party interest groups. (As has been noted, the successful use of this technique would require some changes to existing company law regimes, both in Britain and elsewhere.)

In conclusion, it is difficult to escape the conclusion that too often the use of public enterprise as a means of regulatory control has been unfairly pilloried. While past experience with traditional public ownership structures may have been unsatisfactory for a variety of reasons, this chapter has sought to identify areas in which a more
progressive approach might be taken. It has also attempted to show the kinds of legislative reform which might encourage such developments.

There are still many areas of the British economy in which the need for co-ordination on a national basis and the nature of the services provided furnish strong arguments in favour of some form of public ownership, either in whole or in part. Many of the present difficulties facing the privatised rail industry, as will be described in the next chapter, have arguably arisen because of the lack of a coherent, overall approach of the sort that public ownership and control had previously provided. Such sentiments may no longer be universally popular in an age of widespread privatisation. Their possible lack of popularity does not necessarily render them any less valid. It may be that at some future time a less dogmatic attitude to market processes, coupled with the adoption of more flexible techniques and a conducive legal framework for their implementation, may allow the concept of public ownership in western economics to have a fairer trial.
4. AN EVALUATION OF OTHER TECHNIQUES OF ECONOMIC REGULATION

4.1 Introduction

This chapter examines some basic techniques of economic regulation with a view to assessing the merits of these differing approaches in terms of the regulatory benchmarks described in chapter 1. Six of the most common regulatory methods are analysed: external regulation by agency or commission, franchising/contracting, negotiation and bargaining, taxes, subsidies and tradeable permits, reliance on the general competition law and finally industry self-regulation. Each of these techniques will be evaluated in terms of the attributes which define an ideal regulatory system. This exercise will be of use when a unified regulatory theory comes to be developed in chapter 5.

This analysis will draw on existing UK and overseas experience with the use of these various techniques to date, although in keeping with the analytical approach adopted in this chapter, a more detailed examination of practical regulatory experience in specific areas of the contemporary UK economy will be reserved for chapter 7. The present chapter analyses the agency model in some detail and considers this popular regulatory technique in the context of the control of monopoly market power. It also assesses agency regulation with reference to theories of bureaucracies and organisations, such as the work of Max Weber in this area. The place of agencies in the regulatory spectrum will also be considered.

The section on franchising and contracting examines some of the legal difficulties which can arise with a regulatory regime based principally on these techniques. It considers the central importance of the design of the applicable contractual framework and the difficulties of ensuring ongoing oversight of the franchisee's obligations. These problems are considered against the backdrop of contemporary experience with the use of franchising in Britain, particularly in relation to rail privatisation and the licensing of television channels by the ITC.

Negotiation and bargaining and the use of taxes, subsidies and tradeable permits and incentives are assessed in the context of recent experience with these devices,
particularly in the employment and environmental areas. Reliance on the general competition law is perhaps the most extreme form of 'light-handed' regulation in use in the economic area, and is one that has generally not been favoured in the United States. It is the method currently adopted in relation to UK local bus transport and in jurisdictions such as New Zealand, where reliance on market forces in areas such as telecommunications has given rise to various problems in practice. These aspects will be considered in the course of the discussion of this technique.

Finally, industry self-regulation, both in its 'pure' form and in combination with varying degrees of externally imposed regulation, represents an increasingly important regulatory method in the economic sphere. The chapter will conclude its examination of individual regulatory techniques by looking at the legal and philosophical basis for self regulatory regimes and experience with their use in areas of the modern British economy.

After these individual regulatory techniques have been discussed, the chapter turns to consider the use of rules and discretion in economic regulation, an area which will be of importance to the subsequent development of the thesis. Finally the chapter summarises its conclusions in the above areas.

4.2 The Use of External Regulatory Bodies as a Means of Regulatory Control.

4.2.1 The Need to Control Monopoly Power

While a substantial body of academic and economic opinion inclines to the view that some form of externally imposed regulation of natural monopoly is necessary in the public interest, such a view is by no means unanimous, as was noted in chapters 1 and 2. Many economists take the view that the problems of monopoly power can be adequately addressed by encouraging the creation of a competitive market with low barriers to entry. Even among those who favour regulatory intervention, there is a great deal of divergence of opinion on the justification for, and the form of, an appropriate regulatory regime. This debate has often translated into a critique of the merits of
externally imposed regulation through agencies and commissions, an approach which
dates back at least as far as the writings of John Stuart Mill on this subject last century.¹

In his article on utilities regulation written in 1968, the Chicago economist Harold
Demsetz expressed the view that in an ideal world market competition was more
efficient than regulation by commission or other external means and that the historical
impetus for regulation had often originated from the regulated industries themselves.²

However, recognising the undesirable attributes of monopoly power and the
imperfections which could arise in markets, Demsetz came to the view that although
regulation might not be desirable in an ideal world, "the basic intellectual arguments for
believing that truly effective regulation is desirable have not been challenged."³

Sir Christopher Foster, in his recent book on the regulation of natural monopoly, also
recognised that some form of regulatory intervention was necessary where there were
structural difficulties inhibiting the development of competitive market forces.⁴ It is

1. See for example the essay written by Mill in 1851, "The Regulation of the London Water Supply" in
   Mill's essays originally published between 1850 and 1879), pp 433-434: "The maxim that the supply of
   the physical wants of the community should be left to private agency is, like other general maxims, liable
   to mislead, if applied without consideration of the reasons on which it is grounded. The policy of
   depending on individuals for the supply of the markets, assumes the existence of competition. If the
   supply be in the hands of an individual secured against competition, he will best promote his interest and
   his ease by making the article dear and bad; and there will be no escape from these influences but by
   laying on him a legal obligation, that is, by making him a public functionary. ... The principle, therefore,
   of Government regulations, I conceive to be indisputable. But it remains to be considered whether the
   Government may best discharge this function by itself undertaking the operations for the supply of water,
   or by controlling the operations of others."

2. Demsetz, "Why Regulate Utilities?" (1968) 11 J L & Econ 55 at 65: "In the case of utility industries,
   resort to the rivalry of the market place would relieve companies of the discomforts of commission
   regulation. But it would also relieve them of the comfort of legally protected market areas. It is my belief
   that the rivalry of the open market place disciplines more effectively than do the regulatory processes of
   the commission. If the managements of utility companies doubt this belief, I suggest that they re-examine
   the history of their industry to discover just who it was that provided most of the force behind the
   regulatory movement." For similar approaches to that of Demsetz see Jarrell, "The Demand for State
   Regulation of the Electric Utility Industry" (1978) 21 J L & Econ 269; McChesney, "Rent Extraction and

3. Demsetz, ibid, at p 55.

4. Foster, Privatization, Public Ownership and the Regulation of Natural Monopoly (Blackwell, Oxford,
   1992), p 410: "Arguments have been advanced on empirical, practical grounds that, if a regulatory system
   is cumbersome and expensive, total deregulation may be best, a line of reasoning that may also be based
   on the theoretical arguments of the Chicago school. Yet the case for the regulation of the natural
   monopoly remains strong. Where natural monopoly exists, one cannot rely on market forces. Where
   competition is absent, well-designed and effective regulation can stimulate firms to greater efficiency.
   Competition can, in some cases, be increased by making available access to networks and nodes; but that
noteworthy that both Demsetz and Foster have placed emphasis, in their respective views, on the importance of the effectiveness of an externally imposed regulatory regime. As noted above, economic opinion in this area is far from being unanimous. Stigler, for example, cast doubt on whether regulatory agencies could ever be expected to effect any significant improvement in the lot of consumers or investors when compared with the unregulated alternative. He sought to substantiate this view by examining the performance of regulatory bodies such as the US Securities and Exchange Commission, which he concluded "did not appreciably improve the experience of investors in the new issues market by its extensive review of prospectuses." He was similarly scathing of the US Interstate Commerce Commission and of the Civil Aeronautics Board, which, he considered, were responsible for "very high barriers to the entry of new firms, and the support of a rate structure seriously in conflict with competition." Again, much of the thrust of Stigler's criticism was directed at deficiencies in the regulatory approach adopted by the agencies and he was not so iconoclastic as to deny that the regulatory process gave rise to "occasional triumphs", one of which was the delay, at the insistence of the US Food and Drug Administration, in introducing thalidomide into the United States. Even Hayek, who was not noted for supporting government intrusion into the workings of the market, accepted that controls over monopolistic industries, while often "less satisfactory than they might be", were "a small price to pay for an effective check on the powers of monopoly."

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7. *Ibid*.

8. Hayek, *The Road to Serfdom* (Routledge & Kegan Paul, London, 1944, reprinted 1979). Hayek personally had little difficulty in reconciling himself to whatever deficiencies might be present in a regime designed to regulate monopoly power, observing at p 147 that: "Personally I should much prefer to have
The neo-classical economist Schumpeter, in his well known discourse on monopoly, believed in the power of what he termed the "gale of creative destruction", which he thought was inherent in the technological and competitive processes of the capitalist system, as a means of undermining monopoly power, and this view has been echoed in more recent times. However, such empirical evidence as exists in this area in Britain suggests that monopolistic positions can prove to be remarkably durable over time by reason of factors such as strong barriers to market entry and the not infrequent determination of single, dominant firms to resist the entry of potential competitors into their industry. A recent example is afforded by the market position of National Express, which continued to enjoy a dominant position in the express coaching industry, making it difficult for other operators to compete even after deregulation of the long distance coach transport industry had taken place. Again such an outcome would have been no surprise to the early political economists such as J S Mill. This situation has not been aided by what some commentators consider to have been a relatively passive approach by the Monopolies and Mergers Commission in this area.

12. Mill, writing in relation to early natural monopolies such as the London gas and water companies, observed in 1848: "It is, however, an error to suppose that the prices are ever permanently kept down by the competition of these companies. Where competitors are so few, they always end up by agreeing not to compete. They may run a race of cheapness to ruin a new candidate, but as soon as he has established his footing they come to terms with him." (Mill, *Principles of Political Economy* (Robson (ed), Routledge & Kegan Paul, London, 1967), Book I, chapter IX, p 142.)
13. See the discussion in Utton, "British Merger Policy" in George and Joll (eds), *Competition Policy in the UK and EEC* (Cambridge University Press, 1975) at pp 95-118.
In any event, we should do well to remember the pertinent observation of Keynes that market forces may remedy economic difficulties in the long run, but "in the long run we are all dead."\(^\text{14}\)

In the United Kingdom context the architects of privatised industry, the Thatcher government, certainly were aware, at least ostensibly, of the dangers of unrestrained monopoly as was noted in the 1983 Conservative Manifesto.\(^\text{15}\) The fact that an administration with a strong ideological commitment to a free market philosophy saw the need to introduce natural monopoly regulation is evidence in itself of the fact that an unregulated, privately-owned monopoly operating in an essential area of the economy is not a phenomenon that many governments are likely to tolerate lightly. Experience from other jurisdictions tends to bear out this prediction, as subsequent chapters will illustrate. Until shareholders outnumber consumers of services, political awareness of the consequences of unrestrained monopoly power is never likely to be far beneath the surface.\(^\text{16}\)

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15. The *Conservative Manifesto 1983* (Conservative Party Central Office, London, 1983), p 17: "Merely to replace state monopolies by private ones would be to waste an historic opportunity. So we will take steps to ensure that these new firms do not exploit their powerful positions to the detriment of consumers or their competitors. Those nationalised industries which cannot be privatised or organised as smaller and more efficient units will be given top-quality management and required to work to clear guidelines."

16. As of July 1996 there were about 10 million private shareholders in Britain. Private shareholders in BT numbered about 2.4 million, in British Gas about 1.7 million, in National Power and Powergen about 2.2 million in total, with a similar number in the regional water and electricity companies. There were about 11.1 million men and 10.9 million women in employment and a total of about 20 million individual households. See article in *The Times*, 6 July 1996, "When the many are the few." The link between the distribution of shares in privatised natural monopolies and the comparative strength of the consumer lobby on pricing issues has been recognised by some UK commentators. See for example Brittan, "The Politics and Economics of Privatisation" (1984) 55 Pol Qty 109 at p 123: "The populist agitation against energy prices which reflect long-term marginal costs and current market values would fall on much less fertile soil if the gas and electricity industries had millions of shareholders. It must be admitted, however, that mass shareholders, like any others, would have an interest in high profits and high prices arising from the exercise of monopoly power as well as from improved efficiency. Once trading in the new shares had got under way, there would be a relatively concentrated producer interest in monopoly profit and a relatively dispersed consumer interest in competition."
4.2.2 The Place of Agencies in the Regulatory Spectrum

The range of options for external regulatory intervention can be viewed as extending along a spectrum beginning at one extreme with light-handed (or nominal) levels of regulation. Here reliance is typically principally centred on general statutory provisions such as the existing competition law, and market forces are expected to provide a sufficiently competitive environment to ensure the control or dissipation of monopoly power. Such a regime may have the benefit of philosophical purity, at least for those on the political right, but it is far from clear that such methods serve to avoid a legalistic approach. They may indeed result in inefficiencies of their own, such as market distortions and protracted and costly litigation between an incumbent monopolist and a prospective market entrant. In jurisdictions where such methods have been adopted, with New Zealand affording perhaps the most prominent example in contemporary Western economies, many of the foregoing problems have rapidly become evident, as will be discussed later in this chapter.

At the other end of the spectrum lies a regime of extensive regulatory intervention, which is often complex, pervasive in its application and may also tend towards excessive legalism. The United States experience with administrative agencies, while satisfactory in many respects, displays some of these less desirable features which an ideal regulatory system should seek to avoid or minimise, as the discussion in chapter 6 will show. Other Commonwealth countries, particularly the two federal jurisdictions of Canada and Australia, have made considerable use of the agency technique as a method of economic regulation, although academic opinion on the subject in both countries has varied from the laudatory to the sceptical.17

17. On the subject of Canadian economic regulation see the three seminal articles by Professor Janisch, "The Role of the Independent Regulatory Agency in Canada" (1978) 27 UNBLJ 83; "Policy Making in Regulation: Towards a New Definition of the Status of Independent Regulatory Agencies in Canada" (1979) 17 Osgoode Hall LJ 46; "Independence of Administrative Tribunals: In Praise of 'Structural Heretics' " (1987) 1 CJALP 1. Janisch adopts a generally sympathetic stance in relation to regulatory agencies, supporting their independence within broad parameters of accountability and advancing the view that the Executive should be able to nominate areas in which detailed rule making activity can be pursued by the agencies themselves. His approach is really a modified version of the US concept of the independent regulatory agency, adapted to the requirements of a federal Parliamentary system. In the Australian federal context some of the difficulties of applying constitutional concepts of 'responsible government' to administrative agencies have been analysed from a somewhat more critical perspective by Professor Goldring in his article "Accountability of Commonwealth Statutory Authorities and 'Responsible Government' " (1980) 11 Fed LR 353.
It is interesting to note that in Australia the powers of the former telecommunications industry regulatory agency, AUSTEL, to counter anti-competitive practices in the Australian telecommunications market have now been transferred to the general competition law body, the Australian Competition and Consumer Commission (ACCC), under legislation recently passed by the Australian federal Parliament. This is no doubt a development which OFTEL, which is in the process of implementing similar powers in the UK, may be watching with interest.

The approach which has been adopted to date in the United Kingdom represents a middle ground, to some extent, between these polarised models of regulation. The use of external regulatory bodies or individual regulators in relation to the privatised utilities and rail transport, combined with limited consultation and public participation in regulatory decision making, has certain advantages in terms of cost and efficiency. However, there are also likely to be corresponding disadvantages in terms of lack of control over regulatory discretion, together with the possibility of decisions being made which do not adequately reflect the interests of all parties, including consumer and environmental perspectives. The United Kingdom model is certainly capable of further development and improvement in these areas, and possible innovations will be discussed in succeeding chapters.

4.2.3 The Relationship between Bureaucratic Theory and Agency Regulatory Structures

It is instructive to consider the organisational nature of regulatory agencies within the context of traditional theories of bureaucracy. The archetypal model of a bureaucratic organisation suggested by the German sociologist Max Weber was of an ordered, hierarchical organisation staffed by expert career bureaucrats and operating within a

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18. See the Telecommunications Act 1996 (Aust) and the Trade Practices Amendment (Telecommunications) Act 1996 (Aust), discussed in Baxt, "Proposals for telecommunications reform" (1996) 70 Aust LJ 359. The proposed powers of the ACCC include power to issue a "cease and desist" order to be known as a "competition notice". For a critical discussion of these initiatives see Baxt, "The New Government Initiative on Trade Practices Regulation in Telecommunications - Another Failure" (1996) 24 Aust BLR 472. Other aspects of telecommunications and radio spectrum regulation not involving competition matters are now the responsibility of a new body called the Australian Communications Authority established pursuant to the Australian Communications Authority Act 1996.
closely defined, rule-bound structure. In his detailed treatment of the subject, Weber envisaged a structure which would function methodically within established levels of graded authority. It would incorporate a monocratically organised office hierarchy with its internal management based around written documents organised in files and staffed by officials having thorough and expert training. The officials themselves would hold office in the pursuit of a vocation which would attract distinct social esteem. In Weber's view, the origins of modern bureaucracy could be traced from ancient civilisations and he believed that bureaucratic organisations in Western civilisation had developed in conjunction with the evolution of the money economy.

Weber also saw the "bureaucratic machine", as he termed it, as having a permanent and impersonal character. This included undertones of secrecy of procedure, with obvious social consequences in terms of the exercise of state power, derived from a knowledge of the internal workings of the state apparatus combined with pervasive administrative influence over the daily life of the citizens.

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21. Ibid pp 204-211.

22. Ibid p 228: "Once it is fully established, bureaucracy is among those social structures which are the hardest to destroy. Bureaucracy is the means of carrying 'community action' over into rationally ordered 'societal action'. Therefore, as an instrument for 'societalizing' relations of power, bureaucracy has been and is a power instrument of the first order - for the one who controls the bureaucratic apparatus." It is interesting to note that in countries such as Japan, where the government bureaucracy continues to exert considerable influence over the activities of Japanese companies, attempts to introduce standardised administrative procedures by legislation have met with a lukewarm, if not hostile, reception. See the article by Buckley, "Japanese Administrative Procedures Law Revisited" (1997) 71 ALJ 23: "Companies remain fearful that open opposition to bureaucratic decisions will result in retribution from other government departments ranging from delays in approvals for new products to overly-strict tax audits...Increasingly, senior bureaucrats acknowledge that while administrative guidance served Japan well in the past, what is needed now is a transparent rule-based bureaucratic system...Administrative guidance worked well in an essentially closed economy and homogeneous culture. Internationalisation and liberalisation in Japan have changed that situation so that many people recognise the need for laws regulating bureaucratic decisions. It seems the change to a more Western administrative system will come. However, this change will be slow as it requires a change in the attitudes of the Japanese towards recognising the primacy of written rules over community norms."
Weber's theory of the characteristics of bureaucracy has been criticised on the grounds that it represents a somewhat rigid and dogmatic (perhaps even Prussian) view of organisational structures and does not take into account any wider social motivations of bureaucrats (which, taking a more charitable view of human nature, might even include the influence of professional pride and a benevolent desire to assist the public). Similarly his theory does not explain why other professional experts who display knowledge and technical competence, such as the medical and legal professions, do not predominantly organise themselves in terms of a hierarchical, bureaucratic structure, but rather assume the model of independent professional practitioners.

Weberian theory envisaged bureaucratic organisations as entities which would progressively expand their power by reason of their technical superiority over other organisational forms and their knowledge of the inner working of government administration. His model, developed in a less complex era, remains a remarkable and enduring analysis of the essential nature of bureaucratic organisations. However, it does not purport to explain the intricacies of modern government organisation and in particular the difficult issue of whether the bureaucracy dominates the government or vice-versa.

This is an issue on which modern sociologists and political scientists continue to differ, particularly in relation to the federal bureaucracy in the United States, where the relationship between Congress and the administrative agencies is a complex one. One school of thought favours the predominant influence of the bureaucracy. Another

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24. See Weber, *Essays in Sociology*, supra note 19 at p 214, where he noted: "The decisive reason for the advance of bureaucratic organisation has always been its purely technical superiority over any other form of organisation. The fully developed bureaucratic mechanism compares with other organisations exactly as does the machine with the non-mechanical modes of production." Again, at p 216 of the same work, Weber notes: "The more complicated and specialised modern culture becomes, the more its external supporting apparatus demands the personally detached and strictly 'objective' expert... Bureaucracy offers the attitudes demanded by the external apparatus of modern culture in the most favourable combination."

25. See for example the views of Niskanen, *Bureaucracy and Representative Government* (Aldine Press, Chicago and New York, 1971), who argues that the bureaucracy predominates by reason of its budget-maximising tendencies which provide it with a comparative advantage in relation to the government, which has less information on the cost factors involved in the bureaucratic process. Niskanen's theory tends to parallel that of Weber to the extent that it envisages bureaucratic entities as being operated by self-interested officials who pursue the object of maximising the budgets and influence of their
views the bureaucracy as one of the instruments used by the legislature, either in the form of Parliament or Congress, to consolidate its position by providing services for constituents in local electorates for the political benefit of the elected representatives.26

The logical long-run consequence of an increasingly dominant bureaucracy might be conceived of as being the Orwellian nightmare of complete regulation of all aspects of individual life, with the accompanying elimination of personal freedom and initiative. However theoretical studies (and probably also intuition) suggest that such an outcome is unlikely under a democratic system. Concerns about the growth of central government (especially topical in the United States) coupled by increased reliance on the informal economy or black market (which would deprive an all-pervasive bureaucracy of its necessary tax-based funding), could reasonably be expected to prevent such a situation occurring long before it became a fait accompli.27

In the present context the Weberian model can provide a helpful analytical tool for assessing the usefulness of the agency model in the regulatory arena. Weber's observations on rule-making activities and their significance in terms of the discretionary powers of individual bureaucrats will also be of importance when the concept of administrative rule-making is discussed in chapter 6. If, as a matter of fact, as opposed to theory, the officials making up a regulatory agency enjoy a position of comparatively unrestrained power in relation to the institutions of government, the degree to which they will exercise discretionary powers may be correspondingly greater and conceivably subject to a lesser degree of control.

From an organisational perspective agencies embody many of the most effective tools for the carrying out of government policy. As Christopher Hood has shown in his study of methods of governmental control, there are four basic aspects to government action. He describes these as 'modality' (being in possession of a strategic store of

department or agency. Niskanen has developed this theory further in his later writings, such as Bureaucracy: Servant or Master? (IEA, London, 1973) and "Competition Among Government Bureaus" in Buchanan (ed), The Economics of Politics (IEA, London, 1978).

26. Such a view is advanced by Fiorina and Noll in their article, "Majority Rule Models and Legislative Elections" (1979) 41 Journal of Politics 1081.

27. For an interesting theoretical discussion of these considerations see Frey, "A Macro-Theory of Bureaucracy" in Hanusch (ed), Anatomy of Government Deficiencies (Springer Verlag, Germany, 1984).
information), 'treasure' (possessing the means of funding desired policies), 'authority' (the legal or official power to demand, forbid, guarantee and adjudicate) and 'organisation' (possession of resources and of personnel with specialist expertise, allowing the implementation of desired policy choices). Hood's theory, while useful as far as it goes, is open to criticism on the grounds that it does not place sufficient emphasis on the coercive powers of government, without which the state may be unable to achieve its desired goals. Certainly, in the context of economic regulation, the ability of the regulator to enforce a particular regulatory regime is of central importance. As will be seen later in this chapter, the power to enforce decisions and require compliance with known rules is one of the central features of modern administrative and regulatory action.

Applying this analysis to the typical regulatory agency, it can be seen that many of the requirements of Hood's model are satisfied. The agency is typically endowed by statute with the means to compel the provision of regulatory information by regulated firms and can use this information in implementing the regulatory process. Its funding is either provided by the state (through appropriations by Parliament or Congress) or through self-funding mechanisms whereby the regulated firms contribute to the running of the agency by way of levies. Authority to regulate is conferred on the agency by primary and sometimes also subordinate legislation. It can arrange to hire staff with suitable specialist expertise and to take external advice from professional advisers where necessary.

The instruments available for use by the typical regulatory agency are therefore a close reflection of the 'tool kit' available to the state itself, to adopt Hood's terminology. From a sociological perspective, independent regulation therefore incorporates all the essential attributes of government action, although the issue of whether action by a regulator is equivalent to action by the state is legally somewhat more problematic. The nature of the relationship between regulatory bodies and the state in both Britain and the United States will be examined in more detail in subsequent chapters.

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29. See the discussion in part 4.8 of this chapter.
4.2.4 Evaluation of Regulation by Agency in Terms of the Regulatory Benchmarks

As in the case of public ownership, it is possible to evaluate the merits of external regulatory bodies in terms of the regulatory benchmarks referred to in chapter 1. However, before embarking on this exercise, it is useful to consider the main advantages which have been claimed for agency regulation. The first of these is specialist expertise. As will be seen from the discussion of US regulation in chapter 6, the early American proponents of the agency concept, such as Landis, believed that the concentration of specialist expertise in an agency bureaucracy would lead to an optimal approach being brought to bear to the solution of regulatory problems in a specific industry context.

The second element is the role of an agency in encouraging transparency of regulatory procedure and participation in regulatory decision making. In the US context this goal has been pursued through the adoption of the standardised procedures set out in the Administrative Procedure Act 1946, combined with wide powers of judicial review and an obligation to ensure that regulatory information is made readily available to interested parties. This has been effected both through 'notice and comment' and trial-type procedures, combined with the use of official information legislation.

In Britain, there are no standardised statutory procedures of this kind but regulatory agencies in the economic area have more recently sought to encourage transparency of procedure and greater participation in regulatory decision making. Some relevant case studies will be discussed in chapter 9. Similarly there is no official information legislation in force in this country and powers of judicial review are more limited in scope than in the United States. The effect of these limitations will be discussed further in succeeding chapters.

Thirdly, the use of external agencies will hopefully lead to greater regulatory efficiency, not only as a result of the concentration of expertise referred to above, but also because agency procedures will ideally be designed to achieve such an outcome. Finally, the ideal agency will operate within a well defined legislative framework and will have established channels of accountability to Parliament.
These characteristics have not always been realised in practice in the context of agency regulation. In the United States, in particular, allegations have been made from time to time that regulatory agencies have fallen under the spell of, or been 'captured', by industry and that the burdens imposed by agency intervention have far outweighed the benefits. These criticisms will be discussed further in chapter 6.

These attributes of the ideal regulatory agency can be considered in the context of the designated regulatory benchmarks. To take the first goal, that of certainty, this requires a well defined legislative mandate combined with sufficiently specific rules or guidelines framing particular agency actions. In the US context, the legislative mandate under which agencies operate is often quite general in its terms. However, this is combined with rigorous and formalised procedures in order to try to achieve certainty of regulatory outcome, though the extent to which this goal has been realised is the subject of continuing debate, as will be discussed in chapter 6. In the UK context, industry regulators have been given considerable individual discretion under the applicable legislation and the statutory criteria setting out the goals of the regulatory system vary in their specificity and coherence, as will be examined further in chapter 7. It is therefore difficult to generalise in this area without examining particular regulatory regimes on a case by case basis.

The goal of accessibility is an area in which UK and US agency practice differs. As set out above, the US regime relies heavily on formal and standardised procedures prescribed by statute. Agencies promulgate detailed rules in particular regulatory areas after pursuing consultation procedures which vary in their degree of formality depending on the nature of the regulatory powers being exercised. In Britain, by way of contrast, regulatory procedures are based more on the discretion of individual regulators, although there has been increasing recent emphasis on transparency of procedure. Rule making activity by individual regulators in the economic area has generally been limited in Britain, and, with the exception of civil aviation route licensing (now much diminished in importance), very little use has been made of trial-type adjudication in UK economic regulation. Chapter 8 examines in more detail ways

30. For a discussion of the importance of this requirement, see Baldwin and McCrudden, Regulation and Public Law (Weidenfeld and Nicolson, London, 1987), pp 33-35.
in which the UK approach to participation and consultation in relation to regulatory
decision making and the use of rule making powers by regulators might be improved.

As set out above, the goal of efficiency is one which, at least in theory, regulatory
agencies are ideally structured to achieve. Whether the regulatory body takes the form
of an independent regulatory commission, as in the United States, or an office headed
by a single individual, as in the case of the UK privatised utilities, there is scope for the
development of considerable specialist expertise involving a number of professional
disciplines. On both sides of the Atlantic, regulatory bodies have tended to assume a
bureaucratic organisational structure. They have various divisions or departments
which deal with different aspects of the regulatory function and commonly have their
own in-house counsel or legal department, together with a large professional staff with
economics, engineering, accounting and other professional backgrounds.\textsuperscript{31}

In practice the differences between a commission structure and a regulatory body
headed by a single individual, while these undoubtedly exist, are not as significant as
the similarities. Both types of regulatory body employ corporatised decision making
processes, with significant regulatory decisions being taken after extensive internal
consultation and advice. In the UK, there have been moves towards appointing formal
advisory committees to assist the individual Directors General in reaching significant
decisions, a mechanism which may also reduce the risk of regulatory capture occurring.

Assessment of regulatory efficiency is a difficult task to undertake objectively, as
success in this area, like beauty, is often in the eye of the beholder. A regulatory regime
which imposes stringent price controls with great efficiency is likely to be viewed in
quite different ways by consumers, shareholders and the directors and management of
the regulated firms themselves. A light handed and lightly enforced regulatory regime
may be expected to invoke quite different reactions from the same parties. Efficiency
therefore needs to be related to a more comprehensive theory of regulatory intervention,
a task which will be attempted in the following chapter.

\textsuperscript{31} For a general discussion of the issue of efficiency in agency decision making see Simon, \textit{Administrative
Behavior} (The Free Press, New York, 3rd ed, 1976), chapter IX.
The fourth goal, that of accuracy, involves the application of regulatory expertise to achieve an optimal result. In the context of agency decision making, this again needs to be placed, from a substantive perspective, within the context of an adequate explanatory theory of regulatory behaviour. From a procedural standpoint, the correctness of a regulatory decision must be capable of assessment in terms of the supporting evidence and the reasons given for the particular decision. These aspects will be examined further in chapters 7 and 8.

The goal of fairness again involves both a procedural and a substantive element. At the procedural level the regulatory process must incorporate procedures which deal justly with opposing interests in the regulatory process. Concepts of transparency and consultation are clearly relevant here. At the substantive level the regulatory outcome needs to balance competing interests fairly. Again the achievement of this goal needs to be assessed in terms of an overall theory of regulatory intervention.

The objective of enforceability is an important one. Regulatory decisions which are widely ignored by regulated firms diminish the authority of both the regulator and the regulatory regime. Regulatory enforcement can of course vary in intensity, ranging from moral persuasion to stringent civil or criminal sanctions. In both the UK and the US, techniques of enforceability vary greatly in their stringency. Both jurisdictions exhibit the full range of enforcement techniques and these are closely related to issues of regulatory structure. Self regulatory regimes, such as those adopted in relation to financial services, frequently differ in their approach to enforcement issues from regimes which depend for their effectiveness on strong deterrence involving substantial criminal or financial sanctions. In the UK context, agency regulation exhibits a range of enforcement techniques, ranging from an emphasis on an educative approach to the use of strong discretionary powers to counter abuses such as anti-competitive market practices. The UK case studies in chapter 9 will examine a range of enforcement techniques used by regulatory bodies such as OFTEL and the Rail Regulator.

The goal of accountability is perhaps the most controversial aspect of the operations of regulatory agencies, both in Britain and the United States. US characterisations of the independent commissions as the 'headless fourth branch' of government are well known, and the nature of these objections will be canvassed in more detail when the US
regulatory system is discussed in chapter 6. In Britain, the wide discretion granted to
individual regulators, combined with their somewhat ambivalent relationship with
Parliament and the Executive, has given rise to persistent criticisms, many of which
have still not been adequately addressed. These will be examined in more detail in
subsequent chapters.

Finally the goal of autonomy remains. The US regulatory agencies enjoy a high degree
of independence in theory, although in practice their scope of operation tends to be
constrained by a variety of factors, including their need to obtain Congressional funding
and support, the fact that their activities are subjected to cost/benefit analysis and other
forms of Executive oversight and the existence of wide ranging powers of judicial
review in respect of agency decisions. In the UK context, government influence over
the exercise of agency discretion often tends to be less direct.

Agencies are of course subject to a range of other constraints and influences apart from
those which are politically generated, including media attention, public perceptions and
lobbying by organised interest groups. There is also the possibility of supervision
through public law remedies. While existing powers of judicial review remain more
limited than in the United States there are signs that this situation may gradually be
changing. Finally, the UK regulators are subject to MMC review in terms of the merits
of their decisions, an avenue which does not exist in the US regulatory scene, although
to a certain extent the wider scope of the process of judicial review in the United States
fulfils a similar role.

While the agency concept suffers from many drawbacks and imperfections it also has
the potential to be sufficiently flexible and responsive to enable it to form the basis of

32. A useful analysis of the sociological context in which agency regulation operates can be found in Hutter
and Manning, "The Contexts of Regulation: The Impact Upon Health and Safety Inspectorates in Britain"
(1990) 12 Law & Policy 103. The authors divide external influences on regulatory agencies into four
general categories: the political, the economic, the scholarly and the media. On this subject see also
Gilboy, "Regulatory and Administrative Agency Behavior: Accommodation, Amplification, and
Assimilation" (1995) 17 Law & Policy 3, dealing with the reactions of agency officials to different kinds
of external influence. The power of the media is of course not to be underestimated. As the case studies
on the failings of rail privatisation collected by Wolmar in The Great British Railway Disaster (Ian Allan
Publishing, London, 1996) have shown, the most effective way of ensuring prompt remedial action by
train operators and regulatory bodies was to threaten to report the failings in Wolmar's column of the
Independent on Sunday, from which his book of case studies was later compiled. See the discussion of
these case studies in part 4.3.3 of this chapter.
an effective regulatory regime in the economic area. Few other regulatory techniques exhibit a comparable capacity for addressing changing market conditions and deliberate anti-competitive behaviour on the part of a dominant firm. The challenge is to improve the agency model still further so as to overcome its failings while at the same time enhancing its strengths. This is one of the tasks which will be attempted in the following chapters.

4.3 Franchising/Contracting as a Regulatory Technique

4.3.1 Experience to Date with Franchising as a Regulatory Technique

Franchising as a regulatory technique is closely related to the use of contractual mechanisms, which are discussed later in this part of the chapter. Economic regulation through franchising is usually based on the creation of a structure in which competitive bids are submitted for the right to carry on a franchised operation. The basis for franchised bidding may vary. In the traditional public utility context, a franchise may be awarded to a monopoly supplier of a utility service which offers to charge the lowest price to customers of that particular utility. However, price need not be the sole basis on which franchises are awarded. The legislation governing delivery of a particular utility or public service may specify that a number of goals are relevant.

For example, in the context of UK rail privatisation, considerations such as the ability of a franchised train operator to provide a competent and efficient service are of importance.33 In relation to the granting of licences for public television broadcasting, which are a form of franchise in that they are offered for competitive tender, the level of proposed expenditure on the service, combined with the ability of the intending provider to fulfil the statutory requirements relating to programme content, variety and service delivery are the crucial factors.34

33. See the discussion in part 7.6.1(i) of chapter 7 relating to the awarding of franchises to train operators on the privatised UK rail network.

34. For the basis on which television licences are awarded under the Broadcasting Act 1990 see part 9.4 of chapter 9.
Franchising techniques first attained popularity in the United States in relation to the regulation of public utility services last century. They evolved in part because US state law, which was the basis for utility regulation in areas such as electricity, had to develop a method of allowing utility companies to operate in a particular area and also to use city streets for the purposes of service delivery, through the laying of gas pipes and water mains and the construction of networks for electricity distribution. Prior to the era of state utility commissions, which commenced in 1907 in New York and Wisconsin, utilities such as electricity were regulated at the municipal level. Under US state law, utility companies were granted franchises for their incorporation and operation and particular cities granted specific franchises to the companies allowing them to use public streets for the installation and delivery of their services.\(^5\)

In areas such as utility regulation, economic theory suggested that the franchising process should be used to promote the public interest by the awarding of franchises to the lowest price bidder. In practice the US system fell far short of this ideal. State municipalities tended to grant concurrent franchises, often on a largely indiscriminate basis, and duplication of services was widespread. The franchising process was frequently accompanied by corruption and influence peddling at the local level.\(^6\) In one particularly blatant instance, the state of Oregon even passed a law requiring the operators of a municipal railway franchise to provide free travel to public officials, though this was subsequently reversed by a popular referendum.\(^7\)

In Chicago, for example, forty-five franchises were granted between 1882 and 1905, of which only one was exclusive. Sixteen franchises duplicated each other in terms of area and in three cases the franchises extended over the whole city. Despite such


liberal franchising policies, economies of scale in a number of US states quickly dictated local mergers between utility companies. To take the case of New York city, for example, although six different franchises for electric companies were in existence in 1887, by 1907 the industry had been entirely taken over by the Consolidated Gas Company. In the rest of New York State, Standard Oil had gained control of all the major electricity and gas supply companies by that time. To this extent the concentration of industry power in the early part of this century is not unlike the present position with the UK utility companies, which have recently been the subject of much merger and takeover activity.

In the US states, the fear of exclusive market power emerging in areas of natural monopoly provided one of the principal incentives for utility regulation to be taken over by state commissions. State legislatures recognised that regulation at the municipal level lacked coherence and a systematic approach and was prone to corruption and the demands of local politics. Regulation at the state level by independent commissioners of integrity who were comparatively well paid and carefully selected was aimed at overcoming these difficulties. Problems of this kind with municipal regulation also led to the economic preconditions for utility franchising through competitive bidding not being fulfilled. As Priest has pointed out, economic theories of competitive bidding for franchises, such as those advanced by Demsetz, depend for their validity on the franchise being for a monopoly utility supplier for the municipality in question, rather than a concurrent franchise, coupled with the ability on the part of the municipal authority to restrict new entry into the local market. The economic theories also tend to ignore the need for continuing capital investment or upgrading of plant during the term of the franchise. The fact that the theoretical construct can rarely be matched by the reality accounts in no small measure for the relative unpopularity of franchise bidding as a regulatory technique.

In the United States, franchised bidding for utilities declined in popularity after state utility commissions were generally established. However, franchising initiatives have continued in certain areas of the US economy, with cable television services providing

a well known example. From time to time, various economists have advocated reconsideration of the use of franchising techniques in relation to public utility regulation. However, it seems unlikely that this technique will be the subject of any widespread resurgence in the United States given the existing legislative structure governing the operations of state public utility commissions and the APA requirements of a public hearing in respect of utility rate setting procedures. There are also difficult questions of judgment involved in choosing between prospective franchisees with differing strengths and weaknesses in various areas, coupled with the problems of continued monitoring of the franchisees' obligations.

4.3.2 An Evaluation of Franchising in Terms of the Regulatory Benchmarks

As in the case of other regulatory techniques, it is possible to assess franchising in terms of the regulatory benchmarks set out in chapter 1. To begin with the goal of certainty, a franchising regime based on a lowest price structure scores highly under this category in that price levels can readily be compared as between competing bidders and the intending franchisee is aware of the return to be expected from the service. However, franchise bidding is rarely as simple as this and frequently involves a subjective evaluation of a range of criteria which the prospective franchisee needs to meet, apart simply from pricing considerations.


In the UK context, this is certainly the position in relation to rail operators and applicants for public television broadcasting licences. Once a franchise has been granted, the degree of regulatory control exercisable by the regulatory body concerned may diminish considerably. The ultimate sanction is of course revocation of the franchise or licence but such a drastic course may not be practically (or politically) feasible, particularly where a continuing rail passenger or television service is concerned. A franchisee which persistently fails to measure up to the conditions under which the franchise was awarded can therefore pose a difficult problem for a regulator, particularly if that franchisee is recalcitrant or requires continual regulatory supervision and oversight. In theory a franchising regime should lead to considerable certainty of outcome, but for the above reasons this goal may not always eventuate in practice.

In relation to accessibility, which is concerned with the openness and transparency of the regulatory regime, there may again be difficulties here. Providing the original conditions for the award of the franchise are publicly available, it should be possible for all interested parties to compete for the franchise and for third parties to monitor compliance by the franchisee with the prescribed conditions. The attainment of this goal depends greatly on the procedures adopted by, and the powers available to, the regulatory body in question. In the United Kingdom, in both the rail and television broadcasting examples, the regulatory bodies concerned have been at pains to ensure the provision of adequate public information to interested parties in relation to the performance and duties of franchisees. However, performance in this area depends very much on the individual regulator concerned under the present UK regime in these areas, given the absence of APA type procedures such as those prescribed by statute in the United States.

So far as the objective of effectiveness is concerned, it should be possible for a franchising system to spell out clearly the obligations of a franchisee. Effectiveness in this context depends on the adequacy of both the original franchise conditions and

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42. See Baldwin, "Regulation: after 'Command and Control' ", in Hawkins (ed), The Human Face of Law (Clarendon Press, Oxford, 1997): "For franchising to work, however, it must be possible to specify the service to be performed; the bidding process has to be competitive and effective enforcement of franchise promises must take place. Adequate service specification is important, first, as a basis for generating competition in the bidding process and second, in order to establish benchmarks for evaluating bids. If specification is unclear, bidders will face uncertainties, and not only will costs of bidding be increased but the costs of uncertainties will be passed on through the system to consumers."
the regulatory regime put in place to ensure their fulfilment. Similar arguments apply in relation to the goal of efficiency. The ability to choose a competent and experienced franchisee is of course a major factor in ensuring that an efficient system is put in place. This of course is one of the potential disadvantages of a regime based solely on lowest cost bidding. A franchisee may be tempted to submit an unrealistically low bid to gain the franchise without any realistic prospect of being able to deliver an adequate service at that price. If the franchisee is successful this will almost inevitably lead to a reduction in levels of service and commitment beneath those originally envisaged by the terms of the franchise, combined with pressure to renegotiate the franchise price upwards.43

Similar considerations apply to the goal of accuracy, in terms of whether the regulatory regime can reach an optimal result. Again, attainment of this objective depends to a large extent on choosing the best qualified franchisee at the outset and then ensuring continuing compliance with the conditions under which the franchise was awarded. As with other aspects of franchising, this requires the regulatory body to combine the wisdom of Solomon with a very good crystal ball. It also requires the regulator to be invested with an adequate range of powers, which is relevant to the issue of enforcement discussed below.

The achievement of fairness, in terms of balancing the interests of participants in the regulatory process, again requires careful attention to the design of the original franchising conditions and their continued monitoring in practice. In relation to the goal of enforceability, as discussed above, the regulator needs a flexible range of enforcement strategies which can be used to secure compliance by the franchisee. Like the nuclear deterrent, a sanction based solely on the prospect of revocation of the

43. Some economists have suggested that these difficulties might be overcome by using the device of the Vickrey auction, in which the franchise is awarded to the lowest cost bidder but at the price bid by the closest competitor (i.e. by the runner-up in the auction). Thus the amount of the lowest bid only determines who wins and not the level of payment the winner receives. For an economic analysis of this device see Crew and Harstad, supra note 39. While the detailed economic arguments involved here are beyond the scope of this thesis, common sense dictates that such a device may not necessarily cure the problem of an unscrupulous franchise bidder who deliberately submits an unrealistically low bid. Such a bidder in effect receives a windfall through winning the auction and also being awarded a higher price for the franchise. In purely economic terms this may not be an undesirable outcome (in that the service ends up being realistically priced) but the suspicion lingers that such a process may not necessarily lead to the most deserving (or reliable) franchisee being awarded the franchise. This is perhaps another example of a case where considerations of economic efficiency and moral risk fail to coincide.
franchise may be considered to amount to Mutually Assured Destruction (for which the acronym MAD seems peculiarly suitable in both contexts.) A regulatory power of this kind is likely to result in mutual brinkmanship rather than the constructive solution of regulatory difficulties.\textsuperscript{44} It may only lead to a determined franchisee with little left to lose calling the bluff of a reluctant regulator.

In terms of accountability, this depends largely on the legislative regime under which the franchisee and its regulator operate. In the UK context, the Director of Passenger Rail Franchising has a relatively high level of political accountability under the Railways Act 1993, whereas the Rail Regulator enjoys considerable autonomy under the same Act. In the case of public television broadcasting, the ITC and its members have a considerable degree of statutory independence in terms of their role in allocating television licences, a situation which has enabled the ITC to weather the storms of judicial review relatively successfully, as will be seen in chapters 7 and 8.\textsuperscript{45} The goal of autonomy, which is to some extent the converse of accountability, involves similar considerations.

In summary, therefore, effective franchising depends largely on two major and interrelated factors. The first of these is the design of the process for the initial award of the franchise itself, which in turn depends upon careful thought being given to the franchise terms themselves, coupled with the selection of a franchisee which is the best qualified organisation for the task, both in terms of financial and moral risk. A firm which is well managed financially, but which is also a 'sharp operator', may not end up serving the public interest particularly well. The same goes for a franchisee which is of unimpeachable integrity but is incompetently managed and poorly funded. As we are told, the road to hell is paved with good intentions.

\textsuperscript{44} See Baldwin, \textit{supra} note 40, p 28, who observes; "Enforcing franchise promises is essential if the advantages of competing for the market are to be reaped. The effectiveness of enforcement depends to a large degree on the ease with which the franchiser can replace an incumbent who performs poorly." See also Grabosky, "Counterproductive Regulation" (1995) 23 Intl Jnl Sociol L 347 at 352: "A deterrent posture may be so ferocious that it defies credibility or even implementation... regulators may be loath to enforce standards which they perceive as too stringent, or to trigger penalties which they perceive as too severe."

\textsuperscript{45} See the discussion of attempts to seek judicial review of the allocation by the ITC of the Channel 3 and Channel 5 television licences in part 8.3.5(ii) of chapter 8.
The second essential factor is to ensure a sufficiently flexible regulatory framework to oversee compliance by the franchised operator with the conditions under which the franchise was awarded. This requires a regulatory regime with an adequately defined legislative mandate and sufficiently flexible regulatory powers to ensure compliance in practice. Sole resort to the 'doomsday' scenario of franchise revocation may be counterproductive in a practical context, as discussed above.

4.3.3 The UK Experience with Franchising in Economic Regulation

The franchising regime applicable to passenger rail transport and public television broadcasting will be discussed in more detail in subsequent chapters. However, some general observations on the use of the franchising process in this way are apposite in the present context.

To begin with rail transport, one of the main difficulties with the passenger rail franchising scheme implemented under the Railways Act 1993 is its inherent complexity, a fact which is well illustrated by the need for over 11,000 separate legal agreements and total estimated legal fees of between £40m and £70m involved in the overall implementation of the new structure. Professional and consultancy fees expended on the rail privatisation process since 1992 totalled some £446m, which would certainly have purchased an enormous amount of new rail infrastructure, including several hundred miles of new track. While a case might have been made for dismantling British Rail and awarding several regional franchises to individual train operators, such a structure was not adopted. In the final event 25 operating franchises are to be awarded.

46. See article in the Independent on Sunday, 23 June 1996: "Lawyers make £70m from sale of Railtrack" and the response from one of the law firms involved alleging that the true total figure was probably nearer to £40m, with the bulk of this being charged by three major City law firms - The Times, 24 June 1996: "Lawyers defend fees for rail work."

47. See article by Stephen Castle in the Independent on Sunday, 4 August 1996: "Taxpayer foots £450m bill for rail privatisation advisers", recording that the figures provided to Parliament by the then Minister of State for Transport, Mr John Watts, showed that £278m was paid by British Rail, £90m by the Department of Transport and £78m by Railtrack (a total of £446m) for accountants, consultants, lawyers and other professionals. The article noted with concern that several Conservative MPs had been retained as industry consultants and that at least two of the consultants involved had been substantial donors to the Conservative party.
The problems with having a relatively large number of train operators leasing infrastructure from Railtrack in return for the payment of user charges are both philosophical and practical. At the philosophical level, rail infrastructure provides a public benefit as well as simply serving the interests of the operating companies. For example, the provision of such diverse facilities as street lighting surrounding railway stations and their access routes, overhead bridges across railway lines, toilet facilities at stations, adequate station amenities such as waiting and refreshment rooms, left-luggage and lost property services and transport police are all aspects which have a public interest element extending beyond the interests of rail operators and their passengers in many cases. (Local residents passing along unlit station access ways at night would certainly endorse this sentiment, as would local businesses concerned with presenting a positive image to tourists whose first impression of a town or city might be that of a dilapidated railway station with blocked toilets.)

At the practical level, there has been evidence to suggest that rail operators are reluctant to provide improved station and other facilities because of the very real prospect of incurring greatly increased user charges from Railtrack. Relevant examples are not hard to come by, ranging from station lighting to car parking charges for rail users. Many train operating companies are proving reluctant to reinstate or maintain station facilities such as toilets and waiting rooms because this would lead to the value of the infrastructure being reassessed by Railtrack, with consequently higher user charges being levied to reflect the increased value of the facilities.

Other examples include increased charges by Railtrack to local authorities for upgrading station facilities, to the point where such facilities have become

48. For a description of the role of Railtrack plc in the rail privatisation process see part 7.6.1(i) of chapter 7.
49. Wolmar, supra note 32, case study no. 4, "So You Want to See Your Way at Night?", p 20.
50. Ibid, case study no. 11, "So Railtrack is Being Privatised?", pp 34-35.
51. Ibid, case study no. 16, "So You Want to Use the Toilet? (Part 2)", pp 46-47, referring to Bolton station in the Manchester area, where the Greater Manchester Passenger Transport Executive had been about to make a grant available to upgrade toilet facilities and other amenities at the station when it became aware that the improved facility would attract increased user charges from Railtrack. This in turn led directly to the cancellation of the proposed refurbishment.
unaffordable,\textsuperscript{52} costings for new infrastructure facilities which have more than doubled over the past three years following assets being vested in Railtrack,\textsuperscript{53} and inability to obtain new rolling stock for existing train services because of very high leasing rates charged to train operating companies.\textsuperscript{54} Finally, in early 1996 taxis at Cambridge railway station were parking 200 yards away on the station approach road to avoid paying taxi rank usage charges levied by the train operating company to defray Railtrack charges for the use of the station and its facilities!\textsuperscript{55}

It is interesting to note that in response to numerous passenger queries in the above instances, the response from Railtrack was typically that it was required to make a reasonable return on its investment by levying usage charges (although many rail passengers and train operators might differ from Railtrack's assessment of what constitutes a reasonable charge.) In those instances which were referred to the Railways Minister by irate passengers and others, the typical response was that these were matters involving Railtrack and individual train operators and the Government had no direct control over the charges levied.

4.3.4 Problems with UK Rail Franchising

The overall impression from this method of franchising is that the comparatively high charges levied by Railtrack to train operators do act as a significant disincentive to new investment in the rail network at a time when road congestion is increasing and there is every reason to encourage the use of rail transport in preference to private cars and buses. The structure of rail privatisation is this respect represents a clear favouring of the interests of Railtrack shareholders (coupled with the fiscal considerations of ensuring sufficient Treasury income from Railtrack's privatisation to fund projected tax

\textsuperscript{52.} \textit{Ibid}, case study no. 39, "So You Want a New Station?", pp 92-93.

\textsuperscript{53.} \textit{Ibid}, case study no. 50, "So You Want to Open a New Station?", pp 114-115, recording that the cost to Tewkesbury Council of obtaining a new railway station at Ashchurch in Gloucestershire had risen from the original estimate of £353,000 in 1992 to £1,025,000 after the project had been recosted by Railtrack in June 1995.


\textsuperscript{55.} \textit{Ibid}, case study no. 48, "So You Want to Take a Taxi from the Station?", p 110.
cuts) over the interests of passengers and operating companies. A regulatory structure which accorded adequate weight to the legitimate interests of rail passengers and to the underlying public interest would surely have given rise to a different outcome.

A second major area of difficulty with the rail franchising scheme is persuading the train operating companies to cooperate with each other in the delivery of a co-ordinated passenger transport service. In an industry which relies heavily on efficiency of operation and on the provision of accurate and readily available route and fares information in order to coax rail passengers away from cars and buses, major problems have become evident. The individual train operators have often been concerned with maximising profit from their own franchises, sometimes while also denigrating the service of their competitors.

This has led to difficulties with connecting trains (where some opposing companies have deliberately arranged for their connecting train to depart at a time which prevents a tight connection being achieved by passengers carried by another operator), and problems with obtaining information on services provided by other operators (to the extent where comprehensive regional timetables have either been non-existent or practically unobtainable in many areas, in some cases even by the train operators themselves!) There has frequently been great reluctance to provide advantageous route or ticketing information involving the use of services by another operator and a general lack of co-operation between staff of different operating companies in a number of ways.\footnote{Anyone who thinks that this account is exaggerated should read the 64 case studies in Wolmar, supra note 32, which set out a depressing record of examples of each of these difficulties and a number of similar ones, combined with the equally depressing (and evasive) responses by Railtrack, the train operators involved and sometimes government spokespersons as well.}

The other great difficulty with the rail franchising structure is that while one of the oft-quoted political and legislative justifications for rail privatisation was the introduction of competition on the rail network, this objective was quickly perceived to be largely unachievable. The need to protect the franchise operators against unrestricted competition from rival companies soon became evident as otherwise the franchises would have proved commercially unattractive and therefore unsaleable. One of the major philosophical planks underlying the creation of a privatised rail network was
therefore quickly undermined, a failing from which many would say the whole process has never properly recovered.

Given that the privatised rail network will continue to require large government subsidies, the consequent enrichment of shareholders in Railtrack through large dividend payments funded by substantial user charges seems quite incongruous to any objective observer. Perhaps the final adding of insult to injury is that Railtrack has now been sold extremely cheaply, a fact which even the most devoted adherents of rail privatisation and the free market philosophy have been obliged to concede.\(^\text{57}\) Dividends in October 1995 and February 1996 were funded out of £69m of Railtrack's pre-privatisation profits, with the two payments being worth about 11% of the price of 190p for the shares being sold at public offer. City analysts have calculated that Railtrack shareholders conceivably stood to make up to a 25% return in the first year of their investment.\(^\text{58}\) It is therefore little wonder that private ownership of the railways is regarded with enthusiasm by many.\(^\text{59}\)

All of the above factors illustrate that a complex franchising structure involving numerous rival operators paying high user charges to a single owner of the necessary infrastructure may end up pleasing no-one except shareholders in the owning company, and certainly not the long-suffering users of the service. The example of rail privatisation shows that the whipping boy of a publicly owned British Rail, despite its stale sandwiches and taciturn staff, may not have been so bad after all. Rail passengers appear to agree, given that complaints about rail services in the first year of privatisation soared to record levels, as is shown by the statistics published by the Rail Users Consultative Committee in June 1996.\(^\text{60}\)

\(^{57}\) See article in the \textit{Independent on Sunday}, 12 May 1996: "The last train to fast bucks."


\(^{59}\) \textit{Ibid} p 14.

\(^{60}\) See Central Rail Users' Consultative Committee, \textit{Annual Report 1995/96} (CRUCC, London, August 1996) pp 43-48. This Report noted that complaints about punctuality had increased by a third since the previous Annual Report, complaints about refunds and claims by 20%, about fares and marketing policy by 16.5%, about station environment and facilities by 8.9%, about overcrowding by a staggering 50%, and about representations concerning on-train facilities and services by an even more staggering 78%! 
Experience shows that there are some industries where the problems of network co­ordination and the public service elements inherent in providing the required infrastructure mean that either public, or a mix of public and limited private ownership, are the only really feasible alternatives in the long run. Perhaps one of the least attractive features of rail privatisation is that it has come at a time when BR, which had been recently restructured and which had demonstrated genuine improvements in staff morale, productivity and efficiency, was nevertheless dismembered in the interests of political expediency.

Many of the abuses referred to above could of course be addressed reasonably simply by specifying more stringent rules of conduct for franchisees and investing the Rail Regulator with adequate powers to enforce such conditions. Some controls on the level and nature of Railtrack user charges would also appear to be desirable, with due recognition being given to the desirability of upgrading rail infrastructure as a public good. Such measures are not likely to prove popular with Railtrack or its shareholders, but rail does seem to be one case where too much family silver has been sold to too few for too little. This has been borne out by experience in the market, with at least one rail franchisee selling out at a handsome profit after only seven months of operation, attracting much controversy in the process. A regime of the foregoing kind may well

Certainly the early political economists such as John Stuart Mill entertained few illusions about the desirability of public control as a solution to the problems of natural monopoly in rail. As Mill noted at supra note 12, p 142: "In the case of railways, for example, no one can desire to see the enormous waste of capital and land (not to speak of increased nuisance) involved in the construction of a second railway to connect the same places already united by an existing one; while the two would not do the work better than it could be done by one, and after a short time would probably be amalgamated. Only one such line ought to be permitted, but the control over that line never ought to be parted with by the State..."

Thus Porterbrook, one of the earliest rail franchisees, staged a management buyout of its franchise in November 1995 for a total of £565m and sold the company to Stagecoach, in a deal settled on Friday, 2 August 1996, for a total of £825m, netting a profit to the incorporators of about £83m and to various City institutions for the balance. Of this, £33.9m went to Mr Sandy Anderson, the managing director, and some £30m was shared among a handful of senior executives. The remaining £19m or so was shared by some 43 middle and junior ranking staff, including one of the more fortunate cleaners in the United Kingdom, who was reputed to have received £190,000! See article in The Times, 3 August 1996: "From rails to riches, new millionaires await windfall."; The Sunday Times, 4 August 1996: "The Great Train Robbery." This transaction prompted calls for an immediate capital gains tax covering profits from share sales on a graduated time basis. See for example article by Ian Griffiths in the Independent on Sunday, 4 August 1996: "How to make the fat cats thinner", advocating a capital gains tax regime which would progressively reduce to zero over a ten year period. Given that this windfall profit accrued because the original state assets were clearly sold too cheaply such a move would seem, to this writer at least, to be more than equitable.
represent the shape of privatised rail before long. The incoming Labour government has already indicated that changes of this kind are not far away.\textsuperscript{63}

4.3.5 Franchising of Commercial Television Channels

The UK experience with franchising of public television licences has tended to be more satisfactory, particularly when compared with the situation which applied under the forerunner of the ITC, the Independent Broadcasting Authority. While there have been some periodic difficulties in ensuring compliance by television franchisees with their programming and programme content obligations, the ITC has generally been able to address and resolve these difficulties as they have arisen. In terms of the licence allocation process itself, the courts have tended to accord reasonable deference to the specialist expertise of the commission in this area. More will be said about this subject in part 8.3.5(ii) of chapter 8.

The licence allocation procedures of the ITC, which are largely internal deliberations based on the information and documentation presented by the competing tenderers, may be contrasted with the relatively formal allocation procedure adopted by the FCC.

\textsuperscript{63} In its draft election manifesto published on 4 July 1996 the Labour Party affirmed its rail policy in the following terms: "We have long advocated a partnership of public and private finance to improve rail transport on the basis not of dogma, but of what is best for the customer, the country and the environment. We will create a publicly owned, publicly accountable railway system as economic circumstances and the priorities of transport policy allow." Following its election on 1 May 1997 the Labour Government wasted little time in expressing its desire for stronger regulation of Railtrack and rail franchisees. See for example article in \textit{The Times}, 23 May 1997: "Beckett overrules OFT on railway franchises", reporting that the powers of the Director of Rail Franchising were to be strengthened and that "...John Prescott, the Deputy Prime Minister with responsibility for transport, has pressed the rail regulators to tighten their own control both of train-operating companies and of Railtrack..." The Rail Regulator was not slow to take up the cudgels. See \textit{Statement of Regulatory Objectives for Passenger Train and Station Operators} (ORR publication, London, issued 11 June 1997) and the accompanying press release ORR/97/12, "Rail Regulator says to passenger train and station operators: deliver improvements or face tougher enforcement." In an accompanying letter to franchisees the Rail Regulator observed: "I am expecting a clear commitment from you, individually and collectively, to deliver improvements which promote the use of rail and the public interest generally. I expect you to respond positively to that challenge." On 26 September 1997 the Rail Regulator put into effect agreed amendments to Railtrack's licence establishing an obligation to invest in rail infrastructure and conferring investigatory powers on the ORR. See ORR press release 97/24, 26 September 1997: "Railtrack Investment Programme: Overwhelming Support for Regulator's New Powers"; article in \textit{The Times}, 27 September 1997: "Rail Regulator takes on new powers".


under the Federal Communications Act 1934, prior to recent deregulatory initiatives. Here the conditions for the award of the licence and the relevant part of the broadcasting spectrum to be licensed were first determined by agency rules promulgated under the APA rule making process. A comparative adjudicatory hearing would then be held at which the competing applicants could present their case for the award of the franchise, followed by the agency's decision (and probably also followed in turn by applications to the court for judicial review by the unsuccessful parties.)

The influence exerted by the US APA procedures, requiring clear definition of the terms of issue of the licence through the rulemaking process and the need for a subsequent formal adjudication for the actual licence award, can clearly be seen. There is little scope for argument that the process is not open and transparent. Whether these advantages are outweighed by other less favourable factors, such as cost, complexity and delay, will be examined in more detail later.

In summary therefore, while the concept of regulation through franchising has a certain theoretical appeal to economists and others, its practical implementation can often prove to be more problematic. Perhaps the final word on this issue for present purposes is best given by Ogus, who has expressed a generally sceptical view of the franchising process.

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64. See the account of the FCC licence award process in Breyer and Stewart, *Administrative Law and Regulatory Policy* (Little, Brown & Co, Boston, 3rd ed, 1992), pp 432-474. These procedures have been substantially modified by the Telecommunications Act 1996, as will be discussed in part 10.7 of chapter 10.

65. Ogus, *supra* note 40 at p 334: "As we have seen, an influential group of economists has pleaded the merits of price bidding franchises as being superior not only to the public interest method of allocation, but also to the traditional regulatory solutions to the natural monopoly problem. On our analysis, their claims have been much exaggerated. The reluctance of policy-makers to adopt such schemes, particularly in 'purer' forms, might reflect the influence of private interests that would stand to lose if the more traditional approach were abandoned. But it might indicate a recognition that the systems give rise to difficulties and administrative burdens no less severe than those arising from conventional regulatory regimes. Among these may be highlighted the array of quality standards which, perforce, have to supplement the prices agreed and the problematic issue of contract enforcement."
4.3.6 Contracting as a Regulatory Technique.

Regulatory control can also be exercised through contractual mechanisms. This is a broader regulatory technique than franchising, which is also contractually based, in that it does not necessarily involve a choice between competitive bidders, though this is frequently an aspect of the process.

In the UK context, a contractual approach has recently been adopted in relation to the delivery of various kinds of public services, including the provision of certain health services by the NHS, competitive tendering of local authority services and the contracting out of numerous civil service responsibilities to the Next Steps agencies. At the level of service commitment, individual agencies are expected under the Citizens Charter initiative to detail the levels of service which they expect to achieve and can be awarded a Chartermark for doing so.

As franchising is a particular kind of contracting, the discussion above in relation to the assessment of franchising in terms of the various regulatory benchmarks set out in chapter 1 is generally applicable in the case of regulation through contract. However, at a more general level of abstraction, the use of a contractual mechanism is closely related to issues of rule design. The ability to specify in advance detailed provisions which are binding on a party who contracts to provide certain services readily lends itself to the specification of detailed rules. As in all cases of contracting, the relative bargaining strength of the parties will be a major factor in determining the fairness of the contractual terms which are finally adopted.

The contracting out of some public services has also tended to lead to the defining of separate interests between the provider of the services and the entity on whose behalf they are being performed. This may be both beneficial and detrimental. The process of contracting out local authority services through Compulsory Competitive Tendering (CCT) has sometimes proved to be a divisive influence in terms of the internal administration of the parties.

66. For a general discussion of these developments see Harden, The Contracting State (Open UP, Buckingham, 1992); Freedland, "Government by Contract and Public Law" [1994] Public Law 86.

67. See the White Paper, The Citizen's Charter (Cm 1599, HMSO, London, July 1991) and the discussion in Freedland, ibid, p 90.

68. See the discussion in Harden, supra note 66, pp 32-33.
dynamics of some local authorities. In extreme cases strongly unionised local authority departments have threatened not to cooperate with private contractors who stood to be awarded Council services under CCT. 69

As in the case of franchising, regulation through contract depends heavily on defining the contractual framework sufficiently clearly in advance and putting in place an adequate framework for monitoring contractual compliance. In this latter area there may be difficulties in defining damages suffered by individuals as opposed to the contracting parties, as commentators such as Ogus have pointed out. 70

Experience with using the contracting out of certain public services as a device to promote competition (as in the case of CCT) has been mixed. Many local authority services, such as those involving the provision and maintenance of public sector housing stock, processing of homelessness applications and associated legal services have proved unattractive to private sector bidders. 71 There have been various other complexities involving financial and transfer obligations in relation to employees affected by CCT and in defining which parts of a particular service should be offered for tender. 72 Often the cumulative costs of preparing the conditions of tender, defining

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70. Ogus, supra note 40, p 332; "What then happens if serious breaches are detected? It is here that the weakness of the contractual basis of the regulatory structure is most clearly revealed. English law suffers from its failure to develop an independent set of principles to govern public contracts, in particular to deal with breaches. The conventional private law remedy of damages is inefficacious because the principal losses are incurred by consumers, not the franchisor (the agency)."

71. See article in The Lawyer, 9 January 1996 at p 36: "Councils must explain legal tenders", recording that as few as 100 of the 12,000 law firms in the United Kingdom have submitted bids for Council legal work offered for tender under CCT. See also Ames, "Surviving life in the tender traps", Law Society's Gazette, 3 April 1996, p 8, dealing with the response of local authority legal departments to CCT. I am grateful to Ms Rosemary Hutt, Legal Officer (Housing) with the London Borough of Brent and to Miss Christalla Christodoulidou, housing solicitor with the London Borough of Haringey, for their assistance, when I was writing this part, in referring me to various relevant materials, and giving me the benefit of their practical experience in this area.

72. As an example of legal complexity, the provisions of the Transfer of Undertakings (Protection of Employment) Regulations 1981, SI 1981/1794, (colloquially known as TUPE), are difficult to surpass. See Boyle, "TUPE: The Political Implications for Local Authorities" (1996) 5 Pub. Proc. LR 39; Smerin, "More tussle over TUPE", Law Society's Gazette, 4 October 1995, p 12. These regulations have been held to apply to the newly privatised water companies such as South West Water Services Ltd. See Unison v South West Water Services (unreported, Chancery Division, Blackburne J, 25 August 1994) and
the services involved (a process sometimes necessitating the use of expensive specialist consultants), paying redundancy entitlements and implementing the new structure have far outweighed any competitive benefit arising from the process. The Government's frustration at the evident lack of success of the competitive tendering regime in certain areas, particularly local authority and municipal contracts for legal services, where an estimated 98% of those contracts tendered have been awarded to in-house bidders, has been reflected in attempts to second-guess the tendering process under the relevant statutory provisions.73

It seems fair to say, looked at overall, that CCT has been much less than an unqualified success as a means of stimulating competition in the provision of local authority services.74 The difficulties attendant on regulation through contractual means, as in the case of franchising, have tended to limit the overall usefulness of the contractual model as a comprehensive means of regulation. The lack of an adequate public law framework within which public sector contracting out can be implemented is also a source of difficulty in this area.75 As is often the way of things, ideas which appeal to some economists and which appear workable in theory are often not sufficiently developed to suit the intricacies of the real world. One of our great contemporary failings seems to be that, with regulatory issues, as in many other areas, the facts are too often moulded to fit the theory instead of the reverse.

73. See article by Rose, "Government queries award of legal services contracts" Law Society's Gazette, 26 June 1996, p 24, recording that the Government had sought statutory submissions concerning the tendering process for legal services adopted by the London Boroughs of Enfield and Hounslow, the Barnsley Metropolitan District Council and the London Fire and Civil Defence Authority. For a review of the minimal impact of CCT on the structuring of local authority legal services see Cirell and Bennett, supra note 69, p 20, in which the authors note: "But the CCT exercises the Government has forced local authorities to undertake have not yielded very satisfactory results. The market penetration in terms of legal services has been virtually non-existent, with only two authorities out of about 80 awarding work to private sector firms. The majority of the work, in terms of the quantity of contracts and their value, has been awarded to in-house teams."

74. See for example the discussion in Harden, supra note 66, chapters 3 and 4; Bennett and Cirell, "Compulsory Competitive Tendering for White Collar Services" (1996) 5 Pub Proc LR 67 at 76: "However, one has to question whether or not the same ends could not have been obtained in a different, less conflict-oriented and less expensive manner."

75. See the discussion of this area in Harden, supra note 66, chapter 8.
4.4 Negotiation and Bargaining

4.4.1 Features of Negotiation and Bargaining

Negotiation and bargaining can be employed as a means of economic regulation, and examples of their use can be found in the UK and in other jurisdictions. This technique is related to the preceding method of regulation through contract in that the object of negotiation and bargaining processes is often to bring about a desired state of contractual relations, as in the case of labour market negotiations. However, the scope of this technique is wider than in the case of the contractual model. In the context of UK economic regulation, negotiation and bargaining have tended to operate in peripheral areas, such as negotiations between unions and employers, and in certain defined areas such as development control, where grants of planning permission have in the past been the subject of considerable negotiation between developers and local authorities.

Applying the regulatory benchmarks in chapter 1, it can readily be seen that bargaining processes have strengths in some areas and weaknesses in others. To begin with the goal of certainty, the parties to such a process are presumably aware of the final outcome which they desire from the process and the degree of compromise away from this ideal situation which they are willing to accept. However, the eventual outcome is inherently uncertain and depends in the final analysis on the relative bargaining strengths of the parties involved, their negotiating abilities and the degree of determination with which they pursue their desired objectives. The goal of accessibility is also problematic. The parties themselves have considerable control over the conduct of the process. They can arrange for the negotiations to be held in secret, if they so desire, with the outcome being kept confidential. Parties who may wish to participate can readily be excluded from the process by arrangement between those principally involved. Indeed, third parties may even remain unaware that the bargaining or negotiation process is under way.

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Effectiveness similarly depends upon the degree of likelihood that the parties will reach agreement on terms that are reasonably acceptable to them both. Again this comes down to their relative bargaining strength and the sanctions available (strikes, lockouts, withholding of planning permission and so forth). Much the same can be said in terms of the efficiency and accuracy of the process. It is a procedure which is largely driven by the parties themselves rather than being imposed from the outside. To this extent it can lend itself to flexibility and the prioritising of objectives but the final outcome is largely dependent on the individual characteristics of the parties themselves rather than on any external factors. The fairness of the process is similarly very much a function of the relative bargaining strengths of the parties.

Notions of enforcement may be quite important and these are closely related to the sanctions which the parties are willing to apply to each other in order to achieve their objectives. Again the labour market provides a good illustration of this aspect of the process. Given that the whole process involves minimal third party intervention, notions of accountability and autonomy are of limited application. Where, however, the bargaining process takes place with Government itself (as in plea bargaining over criminal charges, negotiations with the Inland Revenue over tax liability, and discussions about the setting of discretionary standards) there must be a concern that the legitimate public interest in the outcome may not be adequately represented and that the process may indeed take place "in the shadow of the law."

4.4.2 A Process of Limited General Application in the Regulatory Context

The above discussion serves to illustrate the shortcomings of negotiation and bargaining as general regulatory tools in themselves. Where the objective of the regulatory process is to obtain input from a range of participants of varying degrees of market power or bargaining strength then a process more suited to intensive one-on-one interaction is not likely to be productive in achieving this goal.

The above limitations go a long way toward explaining why individualised bargaining and negotiation regimes have rarely if ever formed the basis for any general regulatory

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regimes in the economic area. This is not to say that these techniques have no role to play as an adjunct to other regulatory processes. Indeed some of the discussion in chapter 11 will be devoted to examining how ADR and mediation techniques might be profitably employed to improve external economic regulation while avoiding some of the disadvantages inherent in traditional adversarial procedures.

US regulatory experience shows that negotiation can be combined with other regulatory processes such as rule making to achieve greater efficiency. In America this approach has a statutory basis in the Negotiated Rulemaking Act 1990, as will be discussed in chapter 6. Some European jurisdictions, most notably Germany, have also experimented with regulatory negotiation, particularly in relation to environmental procedures and planning and licensing consents for major projects. Future experience may well show that the use of these techniques in conjunction with more formal external regulatory procedures will come to represent their most productive application.

4.5 Regulation by Incentive - Taxes, Subsidies and Tradeable Permits

4.5.1 The Techniques Described

These techniques of regulatory control have been a feature of the regulatory system from time to time in most jurisdictions. To begin with tax incentives, these have obvious regulatory implications in terms of the costing of alternative courses of action. The tax system can also be used as a negative incentive, in that a well designed taxing regime can discourage the pursuit of particular, undesirable courses of action.

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78. For a recent discussion of the German initiatives in this area see the US/German comparative study of environmental policy in Rose-Ackerman, Controlling Environmental Policy: The Limits of Public Law in Germany and the United States (Yale UP, New Haven, 1995), pp 102-107.

79. In the US context, see Breyer, supra note 76, ch 8, pp 164-174; Mitnick, The Political Economy of Regulation (Columbia UP, NY, 1980), chapter VII. In the UK context see Ogus, supra note 40, ch 9, pp 204-211. For a discussion of the development of these techniques see Lee, A History of Regulatory Taxation (University Press of Kentucky, Lexington, 1973).

80. On the general subject of the use of taxes as a regulatory technique see Ogus, supra note 40, pp 246-248.
action and encourage more acceptable alternatives. Similarly, taxing regimes can penalise undesirable forms of behaviour, such as the creation of air and water pollution, can compensate for externalities and, at the most basic level of analysis, can simply amount to a convenient means of raising government revenue.

Subsidies have the opposite effect to taxes and operate to create a more favourable pricing environment for particular alternative courses of action. They may take the form of direct financial grants (for example, allowances paid directly to students to encourage participation in tertiary education) or payments to promote activities which will lead to indirect changes (such as a planned reduction in water pollution by providing subsidies for the construction of facilities for effluent treatment).

Tradeable permits are in a slightly different category. These recognise the inevitability of a certain level of activity which is undesirable from a regulatory standpoint, such as the generation of air pollution, and seek to provide a regime whereby a specific number of permits authorising an overall level of the particular activity can be granted. These can be sold from one firm to another, so that firms which manage to reduce the occurrence of the undesirable activity gain a financial benefit from the sale of unused permits and firms which do not manage to do so have to pay an additional sum to

81. A common example of this is the tax which some jurisdictions impose on leaded petrol so as to create a price differential with unleaded petrol.


83. A commonly cited example is the tax levied on tobacco products to defray the health costs of treating smoking-related illnesses.

84. One topical example here is the proposal to levy a 'windfall tax' on the £6.7 billion profits of the UK utility companies for revenue raising purposes, a proposal which has attracted periodic support both from within the Government and from the Opposition. See articles in the Sunday Times, 2 June 1996: 'Jittery Tories want utility windfall tax'; The Times, 6 July 1996: "Labour to stick with windfall tax plan;" The Times, 15 April 1997: "Why windfall tax is sound"; The Times, 16 April 1997: "Call for tax to hit smaller water concerns" (describing possible Labour Party plans to extend the proposed windfall tax across the entire water industry). Following the election on 1 May 1997 the windfall tax was included in the 1997 Budget. See article in the Financial Times, 2 July 1997: "The Speech: in summary"; article in the Financial Times, 5 July 1997: "Windfall Tax: End of the Uncertainty."

85. For a general discussion for the use of subsidies in a regulatory context see Ogus, supra note 40, pp 248-249.
acquire further permits. Such a regime has been operated by the US EPA over the past five years in relation to the regulation of sulphur dioxide emissions and has been the subject of some academic analysis and discussion. To date the use of such methods has not been greatly explored outside the United States experience in the emission control area.

4.5.2 Evaluation of these Techniques

The above techniques can be evaluated in terms of the regulatory benchmarks in chapter 1. To begin with the objective of certainty, it is normally possible to calculate with reasonable precision the projected incidence of a tax or subsidy and the potential financial effect of the sale and purchase of tradeable permits, so that in terms of facilitating forward planning by regulated entities, such techniques score reasonably highly.

Issues of accessibility are of limited application in this context. Certain courses of action attract known financial consequences and there is accordingly limited need for third party participation. The workability of tradeable permit schemes does however depend upon the existence of a well informed market operating under defined rules and having sufficient numbers of sellers and buyers for the permits.

The issue of effectiveness is more problematic. A good deal of well-funded professional ingenuity is commonly devoted to avoiding or minimising adverse tax consequences. Subsidies may not always achieve their desired effect and there may be a philosophical conflict between the distributional and incentive goals of subsidy policies. Similarly, as noted above, tradeable permits may lack a genuine market with an adequate number of well-informed possible purchasers. The absence of an auction mechanism under the US scheme allowing for the public sale of superfluous

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86. See for example Ogus, supra note 40, pp 249-250; Van Dyke, "Emissions trading to reduce acid deposition" (1992) 100 Yale LJ 2707; Baldwin, supra note 40, pp 29-30. For a recent survey of the US experience with sulphur dioxide tradeable emission permits see Rose-Ackerman, supra note 78, pp 25-26; Foster and Hahn, "Designing More Efficient Markets: Lessons from Los Angeles Smog Control" (1995) 38 Jnl L & Econ 19. An economic treatment of this area can be found in Beckerman, Pricing for Pollution (Hobart Paper No 66, IEA, London, 2nd ed, 1990).

87. For a discussion of these difficulties see Ogus, supra note 40, p 249.
permits has been the subject of criticism. Similar comments apply in relation to the goals of efficiency and accuracy. The other problem with the use of tradeable permits is that commercially sophisticated polluters with access to highly competent financial and taxation advice may be able to utilise the balance between expenditure on permits and avoidance of pollution in a way which suits their own corporate advantage, rather than in a manner which serves to minimise pollution. There is some evidence that this has occurred under the US system.

In relation to fairness, these techniques may not always strike the right balance between competing interests in the regulatory process. Taxes and subsidies may unfairly penalise or reward various activities. They may prove to be too blunt an instrument for the purposes of flexible and responsive regulatory control. Tradeable permits may not in fact be effectively traded. As Baldwin has pointed out, permit hoarding may also be used to set up barriers to market entry.

Issues of enforcement are obviously important here. Adequate steps need to be taken to monitor compliance with tax regimes and with the conditions for the granting of subsidies. The conditions under which tradeable permits are issued must also be enforced both to prevent contravention of the terms of issue and also to maintain the market value of the permits themselves. If the proscribed activity is not closely monitored in any event then the incentive to purchase a permit is correspondingly reduced.

In terms of accountability, taxes, subsidies and tradeable permits are often issued pursuant to a clear legislative mandate, leading to greater Parliamentary or Congressional accountability. The issue of autonomy frequently does not arise, at least in relation to taxes and subsidies, as an independent regulator is generally not required. In the case of tradeable permits a regulatory body needs to enforce the terms of issue of


90. See Baldwin, supra note 42, p 16.
the permits, compliance with their conditions and with their terms of sale. In the United States this process has been administered by the Environmental Protection Agency as an independent regulatory agency. Any such body needs to have sufficient resources and expertise to be able to administer the permit trading process satisfactorily.

In general, the above regulatory techniques may be particularly effective where there are clear cut policy choices involved between reasonably well defined alternative courses of action. Tradeable permits may be useful in specific regulatory contexts where the conditions favouring a genuine market for their trading exist, a situation which less commonly arises in practice. The latter method is also likely to involve higher administrative cost and may only be suitable for applications in particular areas, such as the environmental protection context.

For those regulatory situations involving continuing interaction with interested third parties, such as the setting of utility price levels and other issues with a consumer element, taxes, subsidies and tradeable permits may lack sufficient flexibility and responsiveness to constitute an adequate overall regulatory regime. These considerations no doubt provide an explanation of the limited use of these techniques in regulatory contexts.

4.6 Reliance on the General Competition Law

4.6.1 Features of this Model of Regulation

From time to time, in both Britain and the United States, as well as in other Commonwealth jurisdictions, suggestions have been made that regulation should be more 'light-handed' and less intrusive. Some commentators have advocated the achievement of these objectives by deregulatory initiatives, under which a specific regulatory regime is replaced wholly or partly by reliance on general principles of antitrust or competition law. These principles are characteristically contained in legislation of general application and are administered by the competition law authority in the particular jurisdiction. Some commentators refer to this technique under the
To a certain extent this approach represents the EC model, particularly in relation to the basic structure of European competition law and policy and concept of the Single Market. Thus, EC competition policy is essentially deregulatory in areas such as telecommunications, transport and airline services.\(^9^2\)

In the US context, Breyer has analysed the operation of unregulated markets operating under the general antitrust laws.\(^9^3\) He has noted the role of US antitrust law in seeking to foster competitive market conditions by prohibiting various forms of undesirable market practice. In applying this legislation the US courts have considered whether anti-competitive practices, on overall balance, give rise to significant injury. This process involves a consideration of whether a particular arrangement has the effect of limiting competition, whether it nevertheless has legitimate commercial purposes and whether these purposes can be achieved in a less objectionable fashion.

Antitrust and competition laws generally proceed on the basis that effective competition can be attained in a particular market. Where this is the case, light handed regulatory techniques of this nature may prove to be workable. As was noted in chapter 1, some US commentators have suggested that the removal of barriers to market entry would constitute an adequate alternative to antitrust legislation,\(^9^4\) although such an approach tends to assume that such barriers can be readily dismantled.

The main difficulty with reliance on general antitrust or competition law is that the market rarely functions with the efficiency which is required for the effective use of this technique. Markets may be dominated by monopoly or oligopoly suppliers who may strenuously resist market entry. (Such a strategy is often pursued under the guise of

\(^9^1\) Baldwin, *supra* note 40, p 27.

\(^9^2\) See the discussion of the EC telecommunications market in part 7.10.3 of chapter 7 and of the EC passenger air transport regime in part 7.8.3(iii) of chapter 7 and part 9.5 of chapter 9.

\(^9^3\) See Breyer, *supra* note 76, pp 156-161.

\(^9^4\) See the discussion in part 1.9.2(iii) of chapter 1.
engaging in legitimate, vigorous competition so that distinguishing between lawful and unlawful competitive conduct may often be difficult in practice.\(^{95}\)

Where one of the conditions for effective participation in the market is access to and use of a dominant firm's existing transmission or distribution network (as in the case of telecommunications, electricity, gas and water) the lack of a workable mechanism to ensure that agreement is reached on such interconnection issues may prove fatal to the interests of an intending entrant. A dominant firm may exploit the absence of regulatory intervention in this area to delay or hinder access to its network. Such action can be overt, in that the owner of the network may aggressively resist attempts to reach agreement, which may lead to litigation in the ordinary courts, as opposed to regulatory hearings where an external regulatory regime is in place. It may also be covert and may consist of conduct ranging from delays in answering correspondence or convening discussions to apparently inexplicable technical and administrative difficulties which prevent resolution of interconnection issues being achieved.

The case study of the New Zealand experience in telecommunications, discussed later in this chapter, provides adequate illustration of the former difficulties. Difficulties of the latter kind, involving less tangible forms of opposition on interconnection issues, have allegedly been encountered in the context of the UK telecommunications industry.\(^{96}\) They are certainly far from being merely hypothetical in nature. There may also be difficulties in achieving a competitive market in certain areas. Rail franchises which are regulated so as to ensure the commercial success of the franchise itself may lead to a restriction in direct competition over certain rail routes, as has been discussed

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95. See for example Whish and Sufrin, *Competition Law* (Butterworths, London, 3rd ed, 1993) at p 268: "The position is delicate because conduct which might in reality be competitive may be condemned as abusive under Article 86 [of the Treaty of Rome] if carried on by a firm wrongly held to be dominant. If this happens, Article 86 could have the paradoxical effect of discouraging firms, fearful of being held to be dominant, from competing on the merits." For examples of cases in which the courts in common law jurisdictions have endeavoured to grapple with the relatively fine distinction between vigorous competition and anti-competitive conduct by a dominant firm see *State of Illinois ex rel Burris v Panhandle Eastern Pipe Line Company* 935 F 2d 1469 (1991) at 1481-1482; *Roland Machinery Company v Dresser Industries Inc* 749 F 2d 380 (7th Cir. 1984) at 394; *Southern Pacific Communications Co v American Telephone & Telegraph Company* 556 F Supp 825 (1983) at 890-893; *Queensland Wire Industries Pty Limited v BHP* (1989) 167 CLR 177 at 191; *Electricity Corporation Limited v Geotherm Energy Limited* [1992] 2 NZLR 641.

96. See for example the apparently unsatisfactory experience of Scottish Telecom in achieving resolution of interconnection issues with BT, as described in part 9.6.5 of chapter 9.
in other chapters. Technical difficulties may frustrate attempts to create direct
competition, such as the fact that drinking water from various sources which is supplied
by companies through the same piping network may chemically interact to produce a
product which is either not potable or is not otherwise attractive to consumers.

Markets may also suffer from excessive competition, a state of affairs in which absence
of external regulation may be just as deleterious. Cut-throat competition is clearly not
in the public interest where the end result of the process is that operators of integrity are
forced out of business and only the strongest and most unscrupulous ultimately survive.
Allegations of this kind have recently been levelled at the UK local bus transport
industry and have also been brought in relation to the deregulated airline industry in
the United States. In relation to US domestic air transport there have been criticisms of
decreasing safety standards, congested airports and aircraft, artificial barriers to entry
through the unavailability of landing capacity at major airports and increasing industry
concentration, although US domestic airfares have undoubtedly decreased in real terms
following deregulation and overall levels of employment in the industry have risen.

It is interesting to note that similar concerns have recently been trenchantly expressed
by the Transport Committee of the House of Commons in relation to safety aspects of
the privatised rail network, especially in relation to the failure of the Franchising
Director to insist on replacing Mark I slam door trains dating back to the 1950s with
new carriages and delays on the part of Railtrack in approving new rolling stock for use

97. See the discussion of the basis for the award of passenger rail franchises in Britain in part 7.6.1(ii) of
chapter 7.

98. This is one of a number of interesting pieces of regulatory information which the writer (who had
previously laboured under the assumption that drinking water was much the same regardless of its origin
and could be happily made to flow through the same pipes) learned at the AIC conference on Regulation
and the Regulators (Park Lane Hotel, London, 2-3 November 1995) from a paper presented by Ms Fiona
Pethick, Head of Competition Policy at OFWAT, entitled "Facilitating Competition in the Water
Industry."

99. See the discussion of this issue in part 7.5 of chapter 7.

100. For a discussion of these factors see Breyer and Stewart, supra note 64, pp 707-708. See also Breyer,
"Regulation and Deregulation in the United States", in Majone (ed), supra note 82, chapter 1 at p 23, who
sets out the relevant statistics in some detail. The relationship between excessive competition and a
decline in levels of service has long been recognised. John Stuart Mill, writing in 1879, observed that:
"Competition is the best security for cheapness, but by no means a security for quality." (Mill, "Chapters
on Socialism (1879)" in Essays on Economics and Society, supra note 1, p 731.)
on the rail network.\textsuperscript{101} Persistent press reports of serious 'near-misses' arising from undetected signalling failures, coupled with the recent Southall crash, have suggested that concerns over safety issues are not lacking in justification.\textsuperscript{102}

One of the problems with relying principally on general competition legislation as a regulatory tool, particularly in the United Kingdom, is the lack of adequate powers of enforcement. In Britain, for example, much enforcement activity is institutional in nature and is carried on through bodies such as the OFT and MMC. Individual actions for damages are not available at the present time, as is the case in both the United States and under EC law.\textsuperscript{103} Criticisms of this situation have been particularly pronounced in areas such as telecommunications, as the case studies in chapter 9 will illustrate.

Regulation by the general competition law is a concept which may seem attractive in theory, but is another area in which the theory rarely matches the practice. In the absence of remedies under UK competition law which are both substantial and enforceable, such a situation is not likely to alter. The case study which follows will serve to illustrate in greater detail some of the problems which can arise.

4.6.2 A Case Study - The New Zealand Experience with this Model

As mentioned above, New Zealand has embarked on an extensive privatisation and civil service restructuring programme, arguably more radical in many respects than that

\textsuperscript{101} See Transport Committee of the House of Commons, \textit{Fourth Report on Railway Safety} (HMSO, London, HC301-I & II, 10 July 1996). The Committee noted at Volume I, para 22: "Although Railtrack must have proper regard for the safety implications of new rolling stock, we are dismayed that earlier progress has not been made towards bringing these trains into service and so enhancing passenger safety. We are appalled that until recently the matter does not seem to have been treated with any urgency and that the Imperial College study was not commissioned until six months after the problem emerged."

\textsuperscript{102} See article in the \textit{Independent on Sunday}, 4 August 1996: "Near-disaster blamed on 'slipping standards'", summarising the conclusions contained in a leaked Railtrack report concerning a serious, unpublicised signal failure near Carstairs in Scotland on 20 May 1996 leading to a "near miss" on the line. The author of the report, Roy Bell, a senior Railtrack official, had identified the new commercial culture of the track and signalling company as a contributory cause of the incident, according to the article. On the Southall crash near London on 19 September 1997, which killed 6 and injured 170, see article in \textit{The Times}, 22 September 1997: "Crash train warning system 'not working'".

\textsuperscript{103} For a discussion of these features see part 6.1.2 of chapter 6 and part 7.9.1 of chapter 7. As this discussion will show there are some recent indications that this situation may be about to change as a result of pending revisions to UK competition law.
undertaken in the United Kingdom. However there are also considerable divergences of approach to regulation in New Zealand compared with the United Kingdom. In the case of public utilities New Zealand has pioneered a regime of light-handed regulation with a strong free market element, relying heavily on its general competition legislation as a regulatory instrument and otherwise leaving market forces (and, as matters have eventuated, the litigation process) to govern economic outcomes in particular industries.

This approach (which in many respects is unique among the OECD countries) has the virtue of a certain philosophical purity (at least from the perspective of its proponents). However, it has also given rise to some significant practical difficulties, particularly in the telecommunications area, which will now be examined in some detail.

The incumbent monopolist in the New Zealand telecommunications industry, Telecom New Zealand, was initially a state owned enterprise which had taken over the telecommunications operations formerly carried on by the state through the NZ Post Office. In the late 1980s two influential reports commissioned by the New Zealand government led to the decision to liberalise the telecommunications sector and to prepare Telecom New Zealand for privatisation.\textsuperscript{104} In September 1990 Telecom was privatised by the sale of its shares by the Government to a consortium consisting of two United States telephone companies, Bell Atlantic and Ameritech, and two New Zealand companies, Freightways Holdings Limited and Fay Richwhite Holdings Limited. (It is worth noting here that the use of 'light-handed' regulatory techniques in the New Zealand telecommunications sector seems to have been motivated not so much by philosophical considerations as by the desire to offer prospective purchasers of the newly privatised Telecom a regime which was largely free from regulatory risk in comparison with most other jurisdictions.)

A public offering of shares was made by the US shareholders in July 1991. Under the terms of privatisation the US interests were required to reduce their combined share ownership to a total of not more than 49.9% by September 1993. The Government exercised some residual control over the privatised operations of Telecom by retaining a single "Kiwi Share" which had certain defined rights, as has been referred to above.

The determination of Telecom Corporation to maintain its pre-eminent market position was evident at an early stage. When the Commerce Commission, the New Zealand regulatory body responsible for general competition and takeover matters, undertook a formal investigation in 1991 into the competitive structure of the telecommunications industry following deregulation, it was successfully challenged by Telecom in judicial review proceedings on the grounds of lack of statutory jurisdiction. The New Zealand High Court held that the provisions of the Commerce Act 1986 did not confer sufficient powers on the Commerce Commission to undertake such an inquiry of its own initiative. The Commission was only empowered to conduct investigations where breaches of the Commerce Act itself were alleged to have occurred.

4.6.3 Litigation in New Zealand over Interconnection Issues

A strong potential competitor to Telecom, Clear Communications Limited, sought to enter the New Zealand telecommunications market in 1990. It commenced negotiations with Telecom for the provision of telecommunications services, initially in the long distance toll call market, and these services commenced in May 1991. Clear also sought to enter the market for local telephone services, beginning with the larger commercial centres, and entered into negotiations with Telecom on the terms of interconnection with the Telecom network.

105. For a discussion of the background to the privatisation of Telecom see the judgment at first instance of the High Court of New Zealand in Clear Communications Limited v Telecom Corporation of New Zealand Limited (1992) 5 TCLR 166.

106. See part 3.2.7 of chapter 3.

Initial discussions were held during the first half of 1991 on a range of technical and pricing issues. At an early stage clear differences of approach in relation to the basis for interconnection became evident. Telecom engaged the services of two eminent United States economists with specialist experience in the area, Professors Baumol and Willig, to advise it in relation to the pricing of interconnection charges. This led to the formulation of a pricing principle by Telecom (which became known as the "Baumol-Willig rule"). Essentially Telecom's pricing position on interconnection was to demand a contribution to its costs, calculated on the basis of foregone revenue together with compensation for any net incremental costs imposed on Telecom by reason of the interconnection arrangements being put in place. In other words Telecom claimed that it should be entitled to charge Clear for line access at a rate which was sufficient to compensate Telecom fully for the loss of profit ("opportunity cost") which it incurred in making interconnection available to its competitor.

Clear's position, on the other hand, was that the same pricing system ought to apply whenever a caller from the Clear network placed a local call to the Telecom network, and that a caller from the Telecom network to the Clear network should similarly pay the applicable local call charge to Telecom. Clear was unwilling to agree to the payment of a network access charge for use of the Telecom network. The parties also differed over whether a distinctive access code ought to be used by Clear's customers, with Clear opposing a stipulation to this effect by Telecom. Despite lengthy and at times acrimonious negotiations between the parties, agreement on the terms of interconnection could not be reached and attempted mediation by the Government through the Minister of Communications was also unsuccessful in breaking the deadlock.

Clear then brought High Court proceedings in New Zealand alleging that Telecom was abusing its dominant market position in the telecommunications industry, contrary to section 36 of the Commerce Act 1986, by declining to provide interconnection arrangements on the terms sought by Clear. After a lengthy hearing, which lasted from 8 June to 2 October 1992, the High Court held that the implementation of the Baumol-Willig rule contended for by Telecom was the most likely method which would result in the promotion and improvement of efficient competition in the New Zealand telecommunications market. Under those circumstances Telecom was not abusing its
dominant market position by insisting on the pricing of interconnection services on that basis. However if Telecom sought to impose charges higher than could be justified on the basis of the rule this would amount to abuse of a dominant market position.

The Court noted that it was not a regulatory agency and could not pursue investigations as to whether or not the internal costings of Telecom, its return on shareholders funds and its general operational efficiency reflected its position as being effectively an industry monopolist, all areas which were closely regulated elsewhere.\footnote{See Clear Communications Limited v Telecom Corporation of New Zealand Limited, supra note 105, at p 218: "It is plain that the whole process to date has been a learning one for both Telecom and Clear. We were told of no other jurisdiction where the same legal situation exists, namely where a free market model is to be used as a test for competitiveness, and Court action the only regulation. In a regulatory sense, it is called the 'light-handed' approach! Everywhere else, especially the US, Britain, and Australia, there is Government intervention and regulation." For a general discussion of the concept of abuse of a dominant market position under s 36 of the Commerce Act 1986 (NZ) see Patterson, "The Rise and Fall of a Dominant Position in New Zealand Competition Law: From Economic Concept to Latin Derivation" (1993) 15 NZULR 265. The comparable Australian provision, s 46 of the Trade Practices Act 1974, is discussed in Corones, "Identifying a Misuse of Market Power in relation to s 46 of the Trade Practices Act" (1989) 17 ABLR 164. The New Zealand Commerce Commission has encountered some degree of criticism in this area on the grounds of its alleged lack of expertise and experience, coupled with what some commentators consider to be a relatively passive approach to industry oversight in this area. See for example, Dordick, supra note 104, p 436: "Backstopping faith in the market and the courts is the Commerce Commission. As now constituted, however, the Commission is not geared to deal with the complexities of telecommunications regulation; its members are concerned with all aspects of fairness in all the newly liberalized markets. These include electricity, domestic air travel, railway service, and petroleum distribution. There are no carefully crafted procedures for determining the extent of competition that exists in certain markets and, inversely, fully determining if anticompetitive practices are occurring. There appears to be no formal oversight proceedings currently in place. Thus, how well the New Zealand approach works depends in part on the Commission's staffing."}

Clear then appealed to the New Zealand Court of Appeal against the High Court's acceptance of the Baumol-Willig model and against the High Court's refusal to award damages against Telecom for a breach of section 36 of the Commerce Act.\footnote{See Clear Communications Limited v Telecom Corporation of New Zealand Limited (1993) 4 NZBLC 103,340.} The Court of Appeal allowed the appeal in part, holding that the negotiating position adopted by Telecom amounted to a misuse of its dominant market position. It held that the Baumol-Willig rule was not the appropriate basis for determining interconnection charges as Telecom's opportunity cost could include monopoly profits, for which it
should not legitimately expect to be compensated in terms of the competitive regime established under the Commerce Act. 110

There was then a further appeal, this time by Telecom, to the Privy Council,111 in which Telecom appealed against the decision of the Court of Appeal that its reliance on the Baumol-Willig rule amounted to a breach of section 36 of the Commerce Act. The Privy Council noted the general rule of competition law that a monopolist was entitled to compete with its competitors as effectively as it could, just as in the case of any market participant.112 It concluded, allowing the appeal in part, that section 36 of the Commerce Act did not oblige Telecom to reassess its financial structure in order to revalue its capital investment and fix a proper return on that figure.113

The approach taken by the Privy Council represents an understandable reluctance to accept the imposition of any regulatory role on the courts in the absence of a clear statutory basis. While the Privy Council's decision may or may not be justifiable as a

110. Ibid p 103,344: "The most that can be done is to state a principle, which can only be that Telecom is entitled to a fair commercial return for granting Clear use of the network assets, without regard to the present monopoly. This means that opportunity cost should be ignored and the charge fixed on the basis of what a network owner not in competition for the custom of subscribers could reasonably charge for use of its facilities. So far the long drawn-out proceedings have benefited no-one apart from Telecom, for the entry of Clear into the market has been delayed."


112. Ibid, (1994) 6 TCLR at p 155. This principle of competition law is derived from cases such as Olympia Equipment Leasing Co v Western Union Telegraph Co 797 F 2d 370 (7th Cir. 1986) per Posner J; Queensland Wire Industries Pty Limited v Broken Hill Pty Co Limited (1989) 167 CLR 177, which were cited by the Privy Council. On this issue see also the discussion in note 95, supra and the accompanying text.

113. Ibid p 160 per Lord Browne-Wilkinson: "If inefficiencies due to monopoly are to be excluded, a person faced with a request for supply will be required to survey the whole of his organisation to discover, for example, whether there is overmanning or inefficient use of plant, factors which are in themselves highly controversial. As the experts agreed, and as the High Court found, such investigations are the function of regulatory bodies who can make decisive value judgments. They are the daily diet of a regulatory body. Such issues could not satisfactorily be carried out unilaterally by the monopolist since he could not know whether the value judgments necessarily involved will be found to be acceptable either to the competitor or, subsequently, to a Court hearing proceedings under s 36. Indeed, the same difficulties would apply if the Court of Appeal's own model was accepted, ie that Telecom was entitled to charge by reference to its 'true costs'." For a critique of the Privy Council's decision in terms of its approach to the competition law issues arising under s 36 of the Commerce Act 1986 (NZ) see Van Roy, "The Privy Council decision in Telecom v Clear: Narrowing the application of s 36 of the Commerce Act 1986." [1995] NZLJ 54.
matter of legal principle, it nevertheless highlights the deficiencies of any system of light-handed regulation where no external regulator is in place. The New Zealand Court of Appeal recognised the power of Telecom, as the existing industry monopolist, and endeavoured to do what it could, within the constraints imposed by the general competition legislation contained in the New Zealand Commerce Act, to redress the situation.

The Privy Council's reluctance to embark on matters of policy and detailed pricing analysis which are more properly the subject of consideration by a regulatory body, however reasonable that approach might be, illustrates immediately the difficulties which can arise where monopoly power is not subject to any effective regulatory intervention. The courts, which are obliged to determine proceedings and appeals on the basis of actual disputes between litigants, are ill-suited to embark on exercises which involve wide-ranging economic and accounting issues (such as the costing structure and economic efficiency of a monopoly supplier) which extend in scope far beyond the matters immediately at issue between the parties.

The other lesson which is evident from the Clear and Telecom saga is that the power enjoyed by an existing monopolist should not be underestimated. The ordinary processes of litigation, embarked upon in the absence of any possibility of invoking the assistance of an external regulatory authority, and in the face of a philosophically unsympathetic political climate, may prove to be quite inadequate as a means of redressing obvious market imbalance. Not only are the courts confined to those issues which the parties choose to raise but the possibility of several levels of appeal renders

The most cogent criticism of the Privy Council's decision is that it implicitly allows a monopoly supplier to distort its internal costings in such a way as to disadvantage prospective competitors. As Sweeney puts it in his paper, Natural Monopolies, Essential Services and Judicial Approaches - A Trans Tasman Comparison (Paper presented to the AIC Utilities Conference, Wellington, New Zealand, 27 April 1995) at p 6: "If the Privy Council advice stands for the proposition that all that a facility provider is bound to do is to make access available on the same terms as it charges itself, then it is open in New Zealand for all bottleneck owners to reorganise their affairs so as to redistribute their profit centres to access provision. Then by requiring the same return of their competitors that they earn themselves, competition will be marginalised." For similar criticisms see Tollemache, "Baumol-Willig Rules, OK? Clear v Telecom (Part III): Decision of the Privy Council" (1995) 4 ECLR 248. It is little wonder that eminent judges disagree on these issues given that there is an absence of unanimity amongst economists themselves as to the proper basis for calculating access pricing to network services. For a survey of the current perspectives on this issue in the context of the US Telecommunications Act 1996 see Sidak and Spulber, "The Tragedy of the Telecommons: Government Pricing of Unbundled Network Elements under the Telecommunications Act of 1996" (1997) 97 Col LR 1081.
any kind of timely resolution of the issues quite unattainable. To even the most ardent
free marketeer it must appear obvious that all is not well with such a system, as
commentators such as Ahdar have aptly noted.115

4.6.4 Arbitration Mechanisms as a Solution to Interconnection Disputes in New
Zealand

A departmental discussion paper from the Ministry of Commerce, issued in August
1995, considered the legislative and other changes which would be required to address
the above difficulties.116 This paper, on which consultation was sought, discussed the
existing problems with telecommunications interconnection negotiations involving
Telecom Corporation and Clear Communications and the implications of this dispute
for regulation of access to vertically-integrated natural monopolies in New Zealand.
After considering the Telecom/Clear litigation and the significance of the Privy
Council's decision, the paper put forward a possible proposal for the resolution of
access disputes by an arbitration panel.117

The arbitration proposal envisaged a convenor and deputy convenor, who were to be
senior lawyers, combined with a panel of arbitrators with relevant professional skills.
A strict timetable for the initial submission to arbitration, various preliminary steps
including an interim directions hearing and the substantive arbitration hearing itself,
were proposed. Reviews and appeals were to be limited to matters of procedural
unfairness and errors of law on the face of the award. The arbitrators were to be given

115. Ahdar, supra note 111, p 116: "Failure to separate the monopolist from its essential facility prior to
privatisation coupled with the non-establishment of an industry-specific regulatory regime, is a recipe for
trouble. The government's own pre-deregulation report envisaged interconnection problems arising
because of this. Having gained a huge financial boost from the sale of Telecom, the government has
subsequently tried to distance itself from the inevitable side-effects of its actions. In Pilate-like fashion,
the regulatory role has been abdicated to the ill-equipped courts. It is probably too late to do anything too
drastic now. Despite the occasional threats of reregulation, this does not seem a realistic prospect. The
tide of laissez faire is still in. Divestiture of the AT & T variety seems equally remote. New Zealand has
made its bed and for now must lie in it."

116. See Regulation of Access to Vertically-Integrated Natural Monopolies. A Discussion Paper (Joint
discussion paper of the Ministry of Commerce and The Treasury, Wellington, New Zealand, August
1995).

117. Ibid Appendix A, particularly pp 69-70.
wide powers to compel disclosure of information, subject to confidentiality orders in appropriate cases. The costs of the arbitration would be met by the parties and the arbitrators would have the power to award costs against the parties in their discretion. Access agreements reached following the arbitration process would be directly enforceable in the High Court and damages could be awarded for failure to comply with the arbitrators' decision.

This proposal represented an innovative solution to the problem of regulatory intervention in that it consisted of a middle way between reliance on individual regulatory powers and discretion, as in the UK context, and the full scale trial-procedures employed in the United States, which could take up to a year for their completion. Under the New Zealand proposal, after the arbitration procedure had been invoked by a party, the projected timetable envisaged a period of 25 working days (or a little over a calendar month) from the start of the process to the completion of an initial conference at which a binding timetable for the whole arbitration would be set. (It might well be that in a complex arbitration the period required for the completion of the whole exercise could approach the time frames involved in the US process, though such an outcome would hopefully be avoided.) Support for a proposed compulsory arbitration regime, which might serve to overcome some of the difficulties associated with voluntary mediation techniques (which are sometimes perceived to lack adequate coercive power in relation to intransigent participants), can also be found among academic and industry commentators.118

The possible use of arbitration techniques in this context will be examined further in chapter 11, which includes some consideration of the general issue of regulatory implementation. If such a regime is not introduced then the only statutory powers available to address the situation under the present New Zealand legislation would be the use of the price control mechanisms contained in Part IV of the Commerce Act 1986. This possibility has been referred to by both the Privy Council and by academic

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118. For expressions of support in this area see Bryant, Chairman of the Industrial Gas Users Group in New Zealand, in his paper entitled What have been the consequences of recent competition reforms to users of monopoly services? (Paper presented to the AIC Annual Utilities Conference, Wellington, New Zealand, 28 April 1995) and Stevenson, supra note 111, p 16 (expressing the view that compulsory arbitration is desirable as a means of resolving interconnection disputes in the telecommunications context).
commentators, and while such an approach would have been inimical to the political philosophy of recent New Zealand Governments there are signs that sympathy for a more interventionist government approach may be emerging.

119. See the decision of the Privy Council, supra note 111, p 103,571; Farmer, supra note 111, p 374; Ahdar, supra note 111, pp 105-108.

120. In a statement released in December 1993, the New Zealand Minister of Communications, the Hon Maurice Williamson, noted as follows: "To maintain conditions of effective competition [in the New Zealand telecommunications market], the Government places primary reliance on the operation of the Commerce Act 1986. ... If it proves necessary, the Government will consider the introduction of other statutory measures or regulation." (Government Statement on Competition in Telecommunications Markets in New Zealand, Minister of Communications, Wellington, New Zealand, 9 December 1993.) In a paper submitted by the Office of the Minister of Commerce and the Office of the Minister of Communications to the Cabinet Committee on Enterprise, Industry and the Environment in June 1996, the Ministries recommended that the existing industry structure involving lighthanded regulation under the Commerce Act ought to continue "on the basis that the Government will be prepared to intervene if it becomes apparent that an incumbent is seeking to restrict competition and that the existing regime appears insufficient to deal with the matter." Janisch, in his article "From Monopoly Towards Competition in Telecommunications: What Role for Competition Law?" (1994) 23 Can Bus LJ 239 at p 274, summarises the prevailing philosophy in the following terms: "Nevertheless, in New Zealand sentiment against government intervention is so strong that no one is yet prepared to talk in terms of a new regulatory agency. 'Regulation' remains largely a taboo word. The most that critics such as Neil Tuckwell of Clear are prepared to come up with is a proposal for a 'government determined process' which involves an 'industry funded referee' to help in dispute resolution 'in accordance with specific government policy guidelines'." A recent survey by the Wall Street Journal of the comparative degree to which 150 national economies were free of restriction and regulation placed New Zealand fourth behind Hong Kong, Singapore and Bahrain. (See The 1997 Index of Economic Freedom (Heritage Foundation in conjunction with the Wall Street Journal, New York, January 1997.)

121. The New Zealand General Election held on 12 October 1996 was the first of its kind under the Mixed Member Proportional Representation ("MMP") system. The election outcome led to the formation of a coalition government between the New Zealand National Party (which had made up the previous government) and the New Zealand First Party, based on a formal coalition agreement dated 11 December 1996. Schedule "A" to this Agreement addressed various policy areas, including telecommunications, where the following general policy statement (dated 9 December 1996) was included:

"Statement of General Direction

Amend Commerce Act to provide for penalties when actions are brought by parties other than the Commerce Commission. Our preference is for the Commerce Commission and the Ministry of Commerce to address competition issues. However, if this does not produce effective competition, Government must be prepared to ensure it does, firstly by producing Government Policy Guidelines to interconnect, transparency and number portability and if necessary by amending the Telecommunications Act."

To date however the New Zealand government has endeavoured to persuade the telecommunications companies to progress interconnection disputes by verbal persuasion, rather than through more formal steps. See for example article in The National Business Review, 7 March 1997, "Telecoms told to grow up", reporting that the Minister of Communications, Mr Williamson, had stated that the major market players were "acting like teenagers". The Minister observed: "They know their own rights backwards but give scant thought to anyone else's rights in the process, particularly users' interests".
It is instructive to compare the long drawn out and litigious process of interconnection in New Zealand with the comparatively expeditious process which occurred in the UK when the original duopoly structure for telecommunications was put in place in 1984-85. A condition was inserted in the licences granted to British Telecom and Mercury Communications at that time authorising the Director General of Telecommunications to determine conditions of interconnection in the absence of agreement.\(^1\)

Mr Bryan Carsberg, the first Director General of OFTEL, recorded in the second OFTEL Annual Report that British Telecom and Mercury approached him concerning the need for an interconnection determination in early 1985. There was initially some delay while the parties disputed the status of a 'Heads of Agreement' document which they had signed the previous year. After it was determined that this document was not contractually binding the issue was then formally referred to the Director General of Telecommunications for determination.

The Regulator considered extensive submissions and held various meetings with the parties before issuing his determination in October 1985.\(^2\) Not counting the time for resolution of the status of the Heads of Agreement, the regulator was therefore able to determine the interconnection issue in less than six months from the date of the initial referral. This compares more than favourably with the attenuated process in New Zealand,\(^3\) which commenced in May 1991, proceeded to the Privy Council and back,

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122. See Licence granted by The Secretary of State for Trade and Industry to British Telecommunications under Section 7 of the Telecommunications Act 1984 (HMSO, London, revised December 1991), para. 13.5: "If after a period which appears to the Director to be reasonable for the purpose the Licensee has failed to enter into an agreement as required by the Operator under paragraph 13.1, then the Director shall, on the application of the Operator or the Licensee, determine the permitted terms and conditions for the purposes of that agreement which have not been agreed between the Licensee and the Operator being terms and conditions relating to the matters mentioned in paragraph 13.4 which appear to the Director reasonably necessary (but no more than reasonably necessary) to secure: ...." (The paragraph then goes on to specify in some detail the matters to be covered by the terms and conditions.) A similar provision can be found in paragraph 12.5 of the licence granted to Mercury Communications Limited. (See Licence granted by The Secretary of State for Trade and Industry to Mercury Communications Limited under Section 7 of the Telecommunications Act 1984 (HMSO, London, revised December 1991).


124. See Regulation of Access, supra note 116, at p 93, para 17: "Use of the legal system for establishing legal rules and applying them is relatively slow and costly. The New Zealand experience has shown that deciding a single (though admittedly difficult) issue - the question of the legality of one interconnection pricing rule - can take several years. At this rate it may take many years before a sufficient body of
and was not resolved until an Interconnection Agreement was signed between Clear and Telecom on 18 March 1996.\textsuperscript{125} Even this agreement may not fully dispose of the various issues which are likely to arise between the parties in the future in the absence of a comprehensive regulatory environment, and the Interconnection Agreement itself can be reviewed if the New Zealand Government makes any major changes to the regulatory environment for telecommunications.\textsuperscript{126} The Agreement also contains various innovative dispute resolution procedures, involving both ADR and arbitration techniques, and these will be the subject of further discussion in chapter 11.\textsuperscript{127}

4.6.5 Evaluation of Regulation by the Use of General Competition Law

The above analysis illustrates that while market processes may be efficient at accomplishing some things, resolving disputes with dominant firms over conditions for market entry would not generally seem to be one of them. (It should be noted, however, that while the OFTEL regime has worked reasonably efficiently in a duopoly situation it has attracted more criticism where the number of firms seeking precedents is established to provide enough transparency about the lawful range of pricing and other behaviour to satisfy a potential entrant. The cost of establishing this body of precedents is borne disproportionately by the present industry participants. Therefore, the body of precedent is likely to develop at a slower rate than is desirable." In an article in the \textit{New Zealand Herald} of 28 November 1996, "Monopolies prove hard nuts to crack", the present Chairman of the New Zealand Commerce Commission, Dr Alan Bollard, was quoted as saying that in the three year period to April 1994 Clear Communications had spent NZ$7m (£3m) in litigation with Telecom, including 300 days of negotiation, 56 days in mediation and 65 days in arbitration!

\textsuperscript{125} The Interconnection Agreement itself was one of a package of several documents signed by on 18 March 1996. These consisted of the Interconnection Agreement 1996, a Settlement Agreement (containing a settlement of past disputes), a Directories Agreement (concerning the provision of directory services for customers of CLEAR) and a Termination Agreement (confirming the termination of earlier interconnection arrangements between the parties). The Interconnection Agreement itself, which runs for a five year period from 1 January 1996 to 31 December 2000, provides a framework for two-way interconnection to network services and sets out a number of reciprocal obligations binding on both parties. The Agreement has been made publicly available by Telecom New Zealand pursuant to the Telecommunications (Disclosure) Regulations 1990 (SR 1990/120, NZ). (In writing this part of the chapter I am grateful for the information provided to me by my partner Jim Stevenson, of the Wellington office of my law firm, Buddle Findlay, who acted for Clear Communications in relation to the preparation of the various agreements signed on 18 March 1996.)

\textsuperscript{126} See clause 7.7 of the Interconnection Agreement.

\textsuperscript{127} See part 11.5.2 of chapter 11.
interconnection with BT has become much larger, as in the past two years, an aspect which will be discussed further in subsequent chapters.)

While an external regulatory regime may suffer from many well known deficiencies, the availability of such a regime, accompanied by suitable statutory powers, may well have served to short-circuit the dispute between the monopolist and the intending market entrant in the Telecom and Clear scenario. It is more than a little ironic that the two US shareholders in Telecom New Zealand are subject to a more rigorous regulatory regime in relation to their operations in the United States, which is often thought of as the bastion of free enterprise, than is applicable to them in respect of their investment in the New Zealand telecommunications industry. Similarly, a regulatory regime could well be expected to override any reliance on the litigation process as a means of delaying market entry by an intending competitor, and as a means of making the process of market entry for such a party as difficult as possible, as has arguably occurred in the Telecom/Clear example.

So far as the choice of regulatory methods is concerned, the New Zealand debate, such as it is in this area, has tended not to favour industry-specific regimes. Certainly the former Chairperson of the Commerce Commission, Dr Susan Lojkine, has (perhaps understandably) made no secret of her preference for a centralised regulatory body. *28 It is also interesting to note that despite trends towards the greater harmonisation of commercial laws in Australia and New Zealand as a result of the Closer Economic Relations (CER) initiative, New Zealand regulatory policy, especially in relation to privatised utilities, differs substantially in its approach from the corresponding regime now taking shape in Australia.

Australian competition law has recently received a radical overhaul with the publication of the Report of the Independent Committee of Inquiry on competition

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128. Lojkine, "The Role of the Commerce Commission in Regulating State-Owned Enterprises" (Speech given at the New Zealand Institute of Policy Studies Symposium, *The Governing Environment for Public Utilities*, Wellington, New Zealand, 6 October 1993): "Another problem with industry-specific regulation is that it involves setting up a body which has nothing else to do but control a particular industry. The tendency is for such bodies to end up making decisions on commercial matters ... to a far greater extent than would be the case with a general enforcement body such as the Commerce Commission. In those circumstances, the risk of bad decisions and market distortions is quite high. The cost to the taxpayer of funding the regulatory body may also be quite high but in any event that is a secondary consideration of less importance than the cost to community of bad decisions being made."
policy (more commonly known as "the Hilmer Report") presented in August 1993.\textsuperscript{129} This report, a comprehensive document which canvassed some significant issues in Australian competition policy, was prepared by a committee chaired by Professor Hilmer over a period of ten months and contains a number of important recommendations.\textsuperscript{130} A detailed analysis of the Report is not required for the purposes of the present discussion but some of its general recommendations are noteworthy. Perhaps the most significant aspect of the Report for present purposes was its discussion of the role of industry-specific regulation in the context of the transition of the public utilities to privatised ownership.

The Committee expressed the view that the key network industries exhibit sufficient common features to justify regulation on a unified basis through one regulatory body. This would not only entail administrative savings but would also provide a unified approach from a national perspective, ensuring that regulatory expertise and experience derived from one industry could be applied to other sectors. The Hilmer Committee concluded that these advantages might not occur if regulation was to be carried on through industry-specific bodies.

The unified regulatory body recommended by the Committee was to be known as the National Competition Council (NCC). It would have representatives from the Federal and State governments and would be responsible for the oversight of Australian competition policy. In addition two new entities were established under the enabling legislation, the Australian Competition & Consumer Commission (ACCC) and the Australian Competition Tribunal (ACT). A good deal of the Report was also devoted to the issue of access to essential facilities. The new body would be given the task of determining if an access problem existed in relation to an essential facility and would have power to decide the terms and conditions on which such a facility would be made available to competitors in the absence of agreement. It could convene an inquiry and issue a report in such circumstances and an arbitration mechanism could be invoked in

\textsuperscript{129} National Competition Policy: Report by the Independent Committee of Inquiry (Aust Govt PS, Canberra, Australia, 1993).

the event of a pricing dispute, as in the case of the New Zealand proposal for setting
terms for interconnection.

The Hilmer Report's preference for a centralised and unified regulatory body, while
also not favouring industry-specific regulation, is sowing the seeds of a much more
interventionist regulatory approach in Australia. As mentioned above, the new
Australian proposals in the telecommunications area (now implemented with effect
from 1 July 1997) call for the general competition law body, the ACCC, to be vested
with powers to counter anti-competitive conduct in the Australian telecommunications
industry, an area which was until recently the responsibility of the industry regulator,
AUSTEL. It remains to be seen whether the new competition body will in fact
amount to some form of de facto industry regulator, while ostensibly applying the
general principles of Australian competition law. If the ACCC is invested with
adequate regulatory powers and is prepared to use them in practice then it may well be
practically indistinguishable from more traditional forms of agency regulation in any
event.

4.7 Techniques of Self-Regulation

4.7.1 The Varying Intensity of Self-Regulatory Regimes

Regulatory regimes based on the concept of self-regulation are becoming of increasing
significance both in the United Kingdom and in other common law jurisdictions. Such
regimes exhibit some similar characteristics to methods of regulation based on some
form of external control but they also have some quite distinctive features of their own.

See the discussion in the text accompanying note 18, supra. The Australian telecommunications industry
is paradoxically facing the prospect of increased regulatory intervention in the deregulatory environment
after July 1997. The ACCC itself has expressed the view that cause for adjudication on interconnection
disputes are likely to be rare but this view is not generally shared by industry participants. See for
example article in The Australian Financial Review, 13 May 1997, "Deregulation? Up to a point, Lord
Copper", recording that telecommunications companies generally envisaged having to resort to the new
regulatory regime for adjudicatory determinations on pricing of "bottleneck" services. This prediction
appears likely to be borne out, with the major new entrant, Optus, announcing on 5 September 1997 that
commercial negotiations over the terms of interconnection to Telstra's network were not progressing and
that mediation, possibly followed by arbitration under the ACCC's auspices, seemed inevitable. See
article in The Dominion (Wellington, New Zealand), 6 September 1997: "Optus-Telstra dispute heads for
mediation".
An examination of the nature of the concept of self-regulation is helpful as a means of shedding some light on the nature and design of regulatory regimes. With this object in view, this part of the chapter examines some aspects of the United Kingdom experience with self-regulation.

To begin with some basic principles, the meaning of the term "self-regulation" should first be considered. As in the case of externally imposed regulation through some form of outside body having authority derived from the State, there are gradations or degrees of intensity of legislative intervention in the self-regulatory arena. It is possible to find light-handed methods of self-regulation where the emphasis is on consensual governance involving a high degree of co-operation between the regulated organisations and their industry association. At the other end of the spectrum it is also possible to find mixed forms of self-regulatory regime, perhaps supported by an extensive statutory framework (and possibly with the threat of state-imposed regulatory methods hovering in the background). Here the industry association or self regulatory body will often have extensive powers of rule making and adjudication backed up by legislation conferring powers of enforceability on the regulator.

Ayres and Braithwaite, in their recent book on the socio-legal aspects of regulatory regimes, draw a distinction between enforced self-regulation and what they term "coregulation". In the view of these authors, enforced self-regulation is a stronger (or less light-handed) method of self-regulation. It incorporates extensive rule-making authority backed up by a system of public enforcement of private rules, together with what they term "publicly mandated and publicly monitored private enforcement of..."

132. Such threats may not even be concealed, as in the case of observations made in the reports on Press self-regulation in the United Kingdom. As the Report of the Committee on Privacy and Related Matters (Cm 1102, HMSO, London, June 1990) concluded at paragraph 17.16 on the subject of a self-regulatory regime for the Press in respect of privacy issues: "The record of the press in this area has not always been good. It must now demonstrate that it can discharge its responsibility and that, through its own conduct and self-regulation, it can command the confidence of the public. If it is not prepared to put and keep its own house in order, further legislation must follow." In the subsequent review of progress in this area completed in January 1993 and presented as Review of Press Self-Regulation (Cm 2135, HMSO, London, January 1993) (better known as the Calcutt Report), the conclusions as to progress with voluntary compliance were less than sanguine. See for example paragraph 5.29: "In my view the press has demonstrated that it is itself unwilling to put in place a regulatory system which commands the confidence, not only of the press (which I am sure it does) but also of the public, and which fairly holds the balance between them; and I see no realistic possibility of that being changed by voluntary action."

those rules". As examples of self-regulatory regimes of this kind Ayres and Braithwaite point to the enforcement of private rules of civil aviation safety in the United States (which are prepared and submitted by the air carrier in question and ratified and enforced through the FAA as a state agency), the United States regime of mine safety (where private mining companies can face criminal prosecution for failing to comply with safety standards prepared by them and publicly ratified through the US Department of Labor) and some of the enforcement activities of the US Environmental Protection Agency (EPA).

The concept of coregulation, by way of contrast, relates to self-regulation by industry association together with some (limited) degree of government supervisory activity. Ayres and Braithwaite describe the United Kingdom regime for the regulation of financial services as being essentially coregulatory in nature.

While accepting that there are clearly degrees of intensity of self-regulatory activity, it may be doubted whether any firm distinction can be drawn between these concepts of self-regulation in the manner suggested by Ayres and Braithwaite. In the case of the financial services sector in the United Kingdom it is clear, for example, that the relevant self-regulatory organisations do in fact possess considerable jurisdictional and disciplinary powers.

They have the power to impose fines and other disciplinary penalties, sanctions which may be significant for firms operating in the financial services area where a reputation for probity, fair dealing and competent and efficient management are often of paramount importance. They can also take steps to suspend a member firm, which

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134. Ibid p 116.

135. Ibid pp 116-117.

136. Ibid p 102: "Rule making and enforcement [in relation to the regulation of financial services in the United Kingdom] are primarily in the hands of industry and professional associations such as the Securities Association and the Association of Futures Brokers and Dealers. A degree of tripartism is secured with the Stock Exchange for example, through a chairman's Liaison Committee of market users. And the state is involved, for example, by the power to rewrite the rules of the self-regulatory organizations."

137. Such disciplinary powers may involve penalties of far more than simply nominal effect. For recent examples in the financial services area see the action of the Securities and Futures Authority (SFA), which in May 1995 imposed a substantial fine of £240,000 on the US investment bank, Morgan Stanley, for admitted deficiencies in the conduct of foreign exchange business on behalf of private clients during 1992 in contravention of the applicable regulatory requirements and the £85,000 fine levied by the PIA on
again is a sanction which can directly affect the financial viability of individual members. To describe the United Kingdom regime in this area as being purely coregulatory (using that term by way of contrast to regimes based on enforced self-regulation) risks oversimplifying the true nature of the United Kingdom self-regulatory regime in this area.

It is also the case that regulatory regimes based on an external regulator may exhibit elements of self-regulation in their structure. As McEldowney has observed in relation to the regulation of the privatised utilities in the United Kingdom, the regulatory regime here consists largely of external regulation. However the enforcement mechanisms which exist have a significant self-regulatory element, being subject in practice to extensive negotiation between the regulator and the utility in question, with the possibility of subsequent referral to the Monopolies and Mergers Commission if agreement cannot be reached. (The existence of this referral power may in itself well act as a strong incentive to the regulated firm to achieve a negotiated compromise.138)

Other commentators in this area view the regulation of financial services in the United Kingdom as amounting to a modern reconstruction of the concepts of corporatism.139 One of the leading writers in this area, Moran, adopts such an approach.140 He views


138. See McEldowney, "Law and Regulation: Current Issues and Future Directions" in Bishop, Kay and Mayer, supra note 11, chapter 17, p 420.

139. For general discussions of the theory of corporatism see Schmitter, "Still the Century of Corporation?" (1974) 36 Rev Politics 93; Newman, The Challenge of Corporatism (Macmillan, London, 1981); Cawson, Corporatism and Political Theory (Blackwell, Oxford, 1986). Theories of corporatism focus on the behaviour and interaction of State-sanctioned interest groups, as in the case of labour negotiations involving tripartite participation by unions, employer groups and the State. Schmitter, at p 94 of his article referred to above, defined the term as follows: "Corporatism can be defined as a system of interest representation in which the constituent units are organised into a limited number of singular, compulsory, uncompetitive, hierarchically ordered and functionally differentiated categories, recognised or licensed (if not created) by the State and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports."

140. Moran, The Politics of the Financial Services Revolution (Macmillan, London, 1991), p 13: "A summary description of the regulatory face of the financial services revolution is therefore as follows: it involves the growing codification, institutionalisation and juridification of corporatist arrangements. By more codification I simply mean that rules are becoming more elaborate and are more likely to be written down than to rest on informal understandings. By more institutionalisation I mean that organisations devoted to the regulatory task are growing in importance: they are acquiring more authority and more resources.
the self-regulation of financial services in the United Kingdom as reflecting a form of
corporatist arrangement in a relatively restricted area. Moran favours the view of
Cawson and others of the distinction between meso-corporatism, and the more wide-
ranging and systemic scope of macro-corporatism.¹⁴¹

Such an approach, while interesting from a socio-legal perspective, tends to lack
analytical power when applied to some of the political and constitutional aspects of
self-regulatory regimes, such as the enforceability of private rules or codes of conduct
by traditional public law and administrative law remedies. This is a difficulty which
has been recognised in more recent times by other commentators in this area such as
Graham.¹⁴² Ayres and Braithwaite express similar reservations as to whether or not
existing public law remedies in common law jurisdictions can accommodate the
situation where administrative rules having a private origin are treated as being publicly
enforceable.¹⁴³

Part of the key to resolving this difficulty would seem to depend upon the way in which
self-regulatory regimes are categorised in terms of their role in performing a public (as
opposed to a merely private) function. If a privately implemented regime of self-
regulation involves a clear public interest element and operates in an area of public
importance and significance (as in the case of the financial services sector) then there is
a strong case for applying public law remedies and principles to such a regime.

¹⁴¹ Juridification I treat as a special kind of codification: it involves putting the rules onto the statute book
and settling disputes about those rules in the courts."

¹⁴² Ibid p 14, with reference also to Cawson's works such as "Varieties of Corporatism: The Importance of
the Meso-level of Interest Intermediation" in Cawson (ed), Organised Interests and the State: Studies in

¹⁴³ Graham, "Self-Regulation" in Richardson and Genn (eds), Administrative Law and Government Action
(Clarendon Press, Oxford, 1994), at chapter 8, p 202: "Furthermore, it is not clear that the courts will
apply the same standard of review to self-regulatory bodies as they seem to do with ordinary public
bodies. In other words they are likely to be more deferential to the decisions of self-regulatory bodies.
...we should remember that the principles developed by the British courts for judicial review have been
developed at a very high level of generality and do not provide much guidance in predictive terms for
individual cases. Nor for that matter is it clear that they are applied consistently by the courts."

¹⁴⁴ See the discussion in Ayres and Braithwaite, supra note 133, pp 123-124.
4.7.2 The Political and Constitutional Nature of Self-Regulatory Regimes

Considerable assistance can be derived in this area by giving some consideration to the political and constitutional nature of a self-regulatory regime in terms of perceptions of what constitutes the essential attributes of a public or governmental function. In recent years much consideration has been given to the issue of whether self-regulatory regimes administered in the private sector are in fact a form of private government having characteristics which are analogous to public government or the exercise of state functions. One of the first modern academic writers to recognise this situation was Professor Charles Merriam. In his early analysis of this issue, published in 1944, Merriam recognised that industry and professional associations and organisations could properly be viewed as exercising what are effectively governmental functions as the private level. He pointed to the fact that such organisations were as well organised, and that in many cases their influence was as pervasive, as that of public political bodies, citing several relevant examples.

Merriam viewed the public and private elements of the democratic system as being reconcilable, in terms of what might otherwise be mutually competing goals, by reason of the fact that in a democratic system all such organisations should be working together to serve the public good. In adopting this view, Merriam saw the organisations of private enterprise as representing an acceptable form of private government which would work in a co-operative manner with the institutions of public government towards the attainment of a cohesive system based on order and justice, fully according in this way with the essential characteristics of a democratic system.

145. Ibid p 9: "All of these groups have their own sanctions or penalties. The state can throw a man into prison. But an employer can take away his job. As the state can deprive a man of his life, the church can threaten his happiness for the future and make him extremely uneasy and unhappy while he lives. The state may tax, but the monopoly may raise prices and lower standards."
146. Ibid p 18: "Finally, in a democratic system, the rivalry sometimes arising between public and private organisations may most readily be reconciled. In a democracy all agencies and authorities are, or profess to be, servants of the common good. They are linked together theoretically in co-operative enterprise. They are aids in obtaining the genuine consent of the governed effectively, with a maximum of reason and persuasion and a minimum of violence and brutality, with an end result of justice."
From a social science perspective, sociologists such as Max Weber also recognised that concepts of "law" or "legal order" could also exist outside the public institutions and authority of the state. For Weber the test was the presence of a power of enforceability rather than the centrality of political control.147

Evan, writing in 1962, endeavoured to identify the sociological characteristics of a legal system, which he viewed as a body of norms operating within a particular social system combined with types of status attracting differing normative functions.148 In this important essay, Evan set about defining the characteristics of public and private legal systems in organisational terms.149

Evan set about applying this analysis to private organisations in an attempt to determine which of those organisations represented an approximation to a democratic legal system. He noted that private organisations and associations differed considerably in their powers and composition and that it was difficult to derive a general theory. In his view the existence of spheres of increased jurisdiction of private legal systems and organisations created a democratic safeguard against oppressive behaviour on the part of agencies of public government, but he also believed that the public legal system had

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147. Weber, Law in Economy and Society, (trans. Shils and Rheinstein, Simon and Schuster Publishing, New York, 1954), p lxvi: "We categorically deny that 'law' exists only where legal coercion is guaranteed by the political authority ... a 'legal order' shall rather be said to exist wherever coercive means, of a physical or psychological kind, are available; ie; wherever they are at the disposal of one or more persons who hold themselves ready to use them for this purpose in the case of certain events; in other words, wherever we find a consociation specifically dedicated to the purpose of 'legal coercion.'" Weber expressed a similar view in his Essays on Sociology, supra note 19 at p 180, in the following terms: "Law exists when there is a probability that an order will be upheld by a specific staff of men who will use physical or psychical intention of obtaining conformity with the order, or of inflicting sanctions for infringement of it."


149. Ibid p 169: "A public legal system has its locus in the formal structures of the state such as the judiciary, the legislature, the executive, and the administrative agency; its jurisdiction extends to all inhabitants of the territory of a society. A private legal system, on the other hand, has its locus in a formal organisation relatively independent of the state; its jurisdiction officially extends only to the organization's members. The second basis of classification involves a vague, multi-dimensional but important distinction between democratic and undemocratic types of legal systems. A democratic legal system includes at least three attributes: (a) the separation of powers, (b) 'procedural due process of law,' and (c) the consent of the governed. The first two attributes have the function of delimiting the authority exercised over the members or the 'laity' of the social system. Through the separation of powers, the three normative functions are so distributed as to prevent a concentration of authority in one and the same status."
a corresponding role in protecting those subject to the authority of private legal systems "against the exercise of arbitrary and autocratic authority".\textsuperscript{150}

Selznick evolved these concepts further in his important essay published in 1969, on the legal nature of private groups.\textsuperscript{151} In Selznick's view it was a proper concern of administrative law to address private sector institutions which shared some of the essential characteristics of public government. He developed the concept of a "law of governance", by which he meant common law principles directed to the establishment and maintenance of free government by way of procedural and substantive legal controls, such as insistence on concepts of due process and recognition of individual rights. In Selznick's view such a concept should apply "wherever the social function of governing is performed, wherever some men rule and others are ruled."\textsuperscript{152}

In evaluating the issue of whether private sector organisations and activities exhibited the characteristics of private government, Selznick took the view that this was an essentially pragmatic inquiry, which should properly focus on the individual characteristics of a particular organisation or association.\textsuperscript{153}

This emphasis on the central significance of rule making authority in identifying the existence of power of a governmental nature highlights another characteristic of rules in this context. Not only do rules promote uniformity of decision-making as well as limiting individual bureaucratic discretion (matters which will be further addressed later in this chapter) but they are also in themselves indicative of the existence of authority of a governmental nature in both the public and private spheres. Similarly, while there are rules which have varying forms of authority and enforceability in all

\textsuperscript{150}. \textit{Ibid} p 181:


\textsuperscript{152}. \textit{Ibid} p 259.

\textsuperscript{153}. \textit{Ibid} p 274: "Private government should not be identified with the existence of centres of power in society. Rather, we should look to the character of the association to see whether and to what extent governance exists. This quest for governance centres upon the nature of group membership and the pattern of authority. The emergence of intrinsic status, important to the social identity of the member and grounded in the explicit aims and structure of the association, creates the private equivalent of citizenship. The minimal concomitants of citizenship are legitimate authority and objective rules. When these conditions exist, or may properly be expected, the realm of public law has been entered."
social groupings (forming a spectrum ranging from rules of law to rules of manners and
etiquette), the essential feature distinguishing governmental authority from less formal
groupings such as kinship and family ties is the existence of an enforceable system of
rules. Such a system imposes uniform and objective standards on those who are
subject to that form of governmental authority, whether it is public or private in nature.

This consideration lends further weight to an argument emphasising the central
importance of administrative rule making in any regulatory structure and also illustrates
why an ideal system of public law should concern itself with activities of a private
governmental nature. If a private authority has the power to impose binding rules on its
members as part of a process of enforceable self-regulation, so displaying powers of a
governmental nature, a developed system of public law should be adequately equipped
to take account of such developments and to exercise control over any abuses present
within such a system where necessary.

Viewed in this light it may, for example, be seen as quite legitimate for a system of
administrative law to exercise full powers of judicial review over the decisions of self-
regulatory bodies where those bodies are performing duties analogous to those carried
out by a public authority. Some recent judicial review decisions in the financial
services area contain some indication that the courts have recognised such a
responsibility, at least implicitly.

In the well known recent case of R v Panel on Takeovers and Mergers, ex p Datafin plc
& anor\(^\text{154}^\) the Court of Appeal, in considering whether a decision of the Panel on
Takeovers and Mergers was amenable to judicial review, held that the supervisory
jurisdiction of the High Court could be applied to any regulatory or supervisory body
which operated as an integral part of a system which carried out duties of a public law
nature and which could impose sanctions on its members. This wider perspective
represented a move away from earlier approaches to judicial review based on the source

\(^{154}\) [1987] 2 WLR 699.
of the power conferred on the body in question, as the learned authors of the most recent edition of de Smith's text on judicial review have noted.155

4.7.3 An Assessment of Self-Regulatory Regimes in Terms of the Regulatory Benchmarks

Self-regulatory regimes are capable of assessment in terms of the chapter 1 benchmarks. To begin with the goal of certainty, this depends on the legislative mandate and the rules or guidelines adopted. In the case of financial services in the UK, detailed rules have been formulated, although in more recent years increasing reliance has been placed on the use of different rule types in this area, including general principles.156 So far as accessibility is concerned, self-regulatory regimes commonly employ consultation procedures in relation to proposed rules and regulatory initiatives. One possible area of concern is whether self-regulation tends to operate in practice so as to favour the views of regulated firms above those of third parties, such as representatives of the consumer or public interest.157 In the case of financial services this concern is somewhat diminished by the terms of the detailed legislative framework within which regulation occurs.

Effectiveness and efficiency may be more problematic in this context. The effectiveness of the existing UK regime for regulation of financial services has been criticised on the grounds of complexity and obscurity and its overall efficiency has also been queried on the same basis.158 However self-regulatory bodies operating in specialised areas such as financial services and the professions might be expected to

155. See de Smith, Woolf and Jowell, Judicial Review of Administrative Action (Sweet & Maxwell, London, 5th ed, 1995) at paras 3-049 to 3-050. As the authors note at para 3-050: "...it is suggested that the approach of focusing on the activities of the body and not only on the source of its authority is helpful."

156. For a general discussion in this area see Black " 'Which Arrow?' Rule Type and Regulatory Policy" [1995] Public Law 94.

157. Such a criticism has been voiced in relation to a variety of self regulatory regimes, including the Press (see note 132, supra), the insurance industry (see for example Hamilton, "The Duty of Disclosure in Insurance Law - The Effectiveness of Self-regulation" (1995) 23 ABLR 359), and domestic clubs and associations (Chen, "Self-Regulation or State Regulation? Discrimination in Clubs" (1993) 15 NZULR 421).

158. See the discussion of the UK financial services industry in parts 7.7.2 to 7.7.3 of chapter 7.
have a better grasp of the particular industry than an outside agency and to have ready access to expertise and industry knowledge.\textsuperscript{159}

In terms of accuracy and fairness, self-regulatory regimes have occasionally been criticised on the basis that they may tend to make regulatory decisions which are unduly favourable to the interests of their members, though such a criticism seems overstated in the context of UK regimes such as that applicable to financial services. The same criticisms have been made in respect of enforceability, although again the UK financial services area provides evidence that relatively stringent enforcement by way of the imposition of substantial fines and suspensions occurs from time to time.\textsuperscript{160}

Finally, considerations of accountability and autonomy attract mixed reactions in the context of a self-regulatory system.\textsuperscript{161} Where the legislative mandate is clear and rules or guidelines are adopted in a transparent fashion, objections based on lack of accountability are less justified. However a self-regulatory regime which functions as a clique, or a gentlemen's club, may attract more legitimate criticism on this ground. The potential for self-regulatory bodies to become self-protecting or self-advancing bodies to the exclusion of the public interest is clear, which gives added weight to the need for concurrent supervision of such regimes by an independent government agency. Such criticisms are not infrequently aired in relation to professional associations and occupational licensing bodies.\textsuperscript{162}

In the US context, where delegation of Congressional legislative powers to self-regulatory bodies has constitutional implications, as the discussion in chapter 6 will

\begin{footnotesize}
\begin{enumerate}
\item See for example Ogus, "Rethinking Self-Regulation" (1995) 15 OJLS 97 at 97-98: "What then are the advantages traditionally claimed for self-regulation over public regulation? First, since self-regulatory agencies (hereafter SRAs) can normally command a greater degree of expertise and technical knowledge of practices and innovatory possibilities within the relevant area than independent agencies, information costs for the formulation and interpretation of standards are lower."
\item See the discussion of this point in part 7.7.3 of chapter 7.
\item For a general discussion of self-regulation from the perspectives of accountability and constitutionality see Page, "Self-Regulation: The Constitutional Dimension" (1986) 49 Mod LR 141; Graham, "Self-Regulation" in Richardson and Genn (eds), \textit{supra} note 142, chapter 8; Black, "Constitutionalising Self-Regulation" (1996) 59 Mod LR 24.
\end{enumerate}
\end{footnotesize}
show, the process requires for its legitimacy concurrent powers of review and independent action on the part of a federal regulatory agency. This is sometimes referred to as 'audited self-regulation'. In the United States much academic attention in this area has been focused on the self-regulatory regime established under the Securities and Exchange Act 1934, where the Securities and Exchange Commission (SEC) exercises statutory oversight over various self-regulatory organisations, such as the New York Stock Exchange and the Securities Industry Association.

The relationship between self-regulation and the techniques of negotiation and bargaining discussed above should also not be overlooked. To the extent that self-regulation confers a level of autonomy on the participants in the process to negotiate their own rules and regulatory bargains, the two techniques have much in common. However, just as negotiation and bargaining can have the effect (by design or otherwise) of excluding other would be participants, so this danger is also present in self-regulatory regimes which engage in direct bargaining with government or with a government agency.

Despite the above areas of difficulty regimes based on self-regulation, established under an adequate legislative mandate and with accompanying oversight by an independent government regulatory body, can offer considerable scope for flexible and innovative regulation in the economic area. From the perspective of a regulatory approach which encourages participation they are obviously well suited to encouraging industry involvement. The challenge is to design structures which also promote, rather than limit or exclude, participation by third party interest groups such as consumers.

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165. For a discussion of the relationship between self-regulation and consensual bargaining see Ogus, supra note 159, pp 100-102.
with the overall objective of furthering the public interest. The model of regulatory intervention to be developed in chapter 5 will deal with such considerations in greater detail.

4.8 Rules and Discretion in UK Economic Regulation

4.8.1 The Concept of a Rule

The interaction between the use of rules and discretion as instruments of economic regulation in the United Kingdom merits some consideration at this point in the course of this review of basic regulatory techniques. Regulatory bodies depend significantly on the use of both of these methods in various degrees of combination.

To begin with the legal nature of a rule itself, this has been the subject of a good deal of jurisprudential analysis, which it is not necessary to examine in exhaustive detail in the present context. However, it should be borne in mind that a rule, in the administrative law and regulatory context with which we are presently concerned, is a more precise instrument than a statement of policy. At the theoretical level there is a continuing debate (perhaps best represented by the positivist views of Hart on the one hand and the purpose-oriented approach of Dworkin on the other) as to whether, and in what respects, rules differ from general principles.\(^\text{166}\)

In the context of administrative rule making, rules are often not merely administrative instruments but can also have some of the attributes of legislation. Just as statutes and the more conventional forms of delegated legislation directly affect the rights of individuals, so can administrative rules, as Professor Jowell has pointed out.\(^\text{167}\)


\(^{167}\) Jowell, "The Legal Control of Administrative Discretion" [1973] Public Law 178 at 201: "We have seen that the process of legalisation involves the transformation of policies into rules. Policies are broad statements of general objectives, such as 'To provide decent, safe and sanitary housing', 'To prevent unsafe driving'. The policy is legalised as the various elements of housing and driving are specified, providing, for example, for hot and cold running water, indoor toilets, maximum speed limits and one-way streets. A rule thus is the most precise form of general direction, since it requires for its application nothing more or less than the happening or non-
Because rules lend themselves to the regulation of recurring factual situations they may be particularly suitable in the context of administrative regulation, as Max Weber observed. This impersonal application of general rules which fit a variety of recurring administrative situations provides an ideal environment for the application of Weber's concepts of dispassionate administration, as several commentators have recognised, and also has discernible political consequences. Indeed it was Hayek (an unlikely intellectual bedfellow of Weber in many ways) who recognised the implications for the maintenance of personal liberty of having rules known in advance.

Hayek considered that administration coercion was illegitimate in the absence of known rules. In his view the availability of rules and guidelines combined with happenings of a physical event. For the application of the maximum speed rule, all we need do is determine factually whether or not the driver was exceeding thirty miles per hour.

168. Weber, *Essays in Sociology,* supra note 19, at pp 215-216: "The second element mentioned, 'calculable rules', also is of paramount importance for modern bureaucracy. The peculiarity of modern culture, and specifically of its technical and economic basis, demands this very 'calculability' of results. When fully developed, bureaucracy also stands, in a specific sense, under the principle of *sine ira ac studio.* Its specific nature, which is welcomed by capitalism, develops the more perfectly the more the bureaucracy is 'dehumanized', the more completely it succeeds in eliminating from official business love, hatred, and all purely personal, irrational, and emotional elements which escape calculation. This is the specific nature of bureaucracy and it is appraised as its special virtue."


170. See Hayek, *The Constitution of Liberty* (Routledge & Kegan Paul, London, 1960) at p 205: "The first point that must be stressed is that, because the rule of law means that government must never coerce an individual except in the enforcement of a known rule, it constitutes a limitation on the powers of all government, including the powers of the legislature." Similarly in his earlier work, *The Road to Serfdom,* supra note 8, at pp 61-62, Hayek noted: "If the law says that such a Board or Authority may do what it pleases, anything that Board or Authority does is legal - but its actions are certainly not subject to the Rule of Law. By giving the Government unlimited powers the most arbitrary rule can be made legal: and in this way a democracy may set up the most complete despotism imaginable."

171. Hayek, *The Constitution of Liberty,* *ibid,* at pp 211-212: "Even the delegation of this power [to make legislative rules] to some non-elective authority need not be contrary to the rule of law, so long as such authority is bound to announce these rules prior to their application and then can be made to adhere to them. The trouble with the widespread use of delegation in modern times is not that the power of making general rules is delegated but that administrative authorities are, in effect, given power to wield coercion without rule, as no general rules can be formulated which will unambiguously guide the exercise of such power."
effective powers of judicial review was an essential element in controlling administrative discretion.\textsuperscript{172} Such a view has been further developed by others in more recent times.\textsuperscript{173}

The fact that reliance on rules is legitimate does not mean, of course, that they should be applied automatically or mindlessly without regard to their intended purpose. However if individual circumstances are to be given complete consideration in reaching any individual administrative decision, possibly with the accompanying requirement of some form of hearing, a point on the spectrum between completely rule-based and completely discretion-based decision making may soon be reached where a general rule will be of limited utility in the decision making process.\textsuperscript{174}

4.8.2 Discretion Contrasted with Rules

As noted above, a significant part of the process of administrative decision making involves achieving the right balance between the use of rules and discretion in the design of administrative rules.\textsuperscript{175} Some degree of discretionary power will inevitably substist in the administrative process, a matter which even the strongest advocates of

\textsuperscript{172} Ibid p 213 where he noted: "In acting under the rule of law the administrative agencies will often have to exercise discretion as the judge exercises discretion in interpreting the law. This, however, is a discretionary power which can and must be controlled by the possibility of a review of the substance of the decision by an independent court. This means that the decision must be deducible from the rules of law and from those circumstances to which the law refers and which can be known to the parties concerned."

\textsuperscript{173} Davis, \textit{Discretionary Justice} (Louisiana State University Press, Baton Rouge, 1969) at p 30 refers to the belief that judicial review should always be available in such circumstances as the "extravagant version of the rule of law". For a further discussion of the implications of such an approach see Jowell, \textit{supra} note 167, at pp 184-185.

\textsuperscript{174} Jowell, \textit{supra} note 167 at p 202, where several examples of a discretionary decision-making process supplanting a rule-based procedure are given. See also Galligan, \textit{supra} note 169 at pp 348-350, where the author notes at p 348: "The central feature of a policy applied as a rule in this sense is that there is no element of discretion as to whether the policy should be applied to a particular situation. It would seem to follow that a policy does not function as a rule (and so is permitted), no matter how detailed and specific its terms, if in each exercise in discretion the decision-maker directs his mind to whether or not the policy should be applied in that situation."

\textsuperscript{175} See also the discussion in parts 9.6 to 9.7 of chapter 9 for practical illustrations of this assertion.
rule-based regimes, such as Kenneth Culp Davis, have accepted. A regulatory regime based solely upon inflexible rules cannot hope to accommodate the variety of human actions, a fact which has been recognised from early times, as Aristotle observed. This principle is illustrated in a more light hearted way in Appendix I to this chapter. The inflexible application of rules assumes elephants can climb trees as well as monkeys. On the other hand the unthinking application of discretion does not succeed in getting the elephant up the tree either.

It is important, however, as more recent commentators have emphasised, not to take too narrow a view of the context in which discretion operates. As Hawkins has reminded us, legal constraints are not the only fetters on discretionary decision making. There are a number of other important factors, including those of an economic, political and organisational nature. Furthermore, legal concepts of the nature of the decision

176. See Davis, supra note 173 at pp 216 - 217: "No legal system in world history has been without significant discretionary power. None can be. Discretion is indispensable for individualized justice, for creative justice, for new programs in which no-one yet knows how to formulate rules, and for old programs in which some aspects cannot be reduced to rules. Eliminating discretionary power would paralyse governmental processes and would stifle individualized justice. Those who would forbid governmental coercion except on the basis of rules previously announced seem to me to have misunderstood the elements of law and of government." See also Jowell, Law and Bureaucracy (Dunellen Publishing Company Inc., New York, 1975), p 169, who observes: "...substantive legalization or judicialization of administrative decision is not possible in a number of situations. The corollary of this proposition is that certain administrative tasks (those that cannot be performed by reference to rule or standard) require a degree of discretion for their effective exercise."

177. Aristotle, The Politics (Rackham trans., William Heinemann Ltd, London, 1932), Book II, 1269a, p 32: "οὐσίαν ἡ ἀνεφορὰ καὶ περὶ τῶν ἀλλάς τεχνῶν καὶ τὴν πολιτικὴν ταξιν ἀδιακοπτον ἀκριβῶς γραφῆσαι καθολικῶς ἀπὸ ἀνακριβῶς γραφῆσαι, δὲ πραξικές περὶ τῶν καθ ἐκαστοῦ εἰσι" ("For just as in the other arts as well, so with the structure of the state it is impossible that it should have been framed aright in all its details; for it must of necessity be couched in general terms, but our actions deal with particular things.")

178. See Hawkins, The Uses of Discretion (Clarendon Press, Oxford, 1992), pp 17-19. For an interesting discussion of the interaction between political factors and agency programs, based on an analysis of the Massachusetts Commission Against Discrimination during the period up to the mid-1970s see Jowell, supra note 176, chapter 6, particularly pp 186-189. See also Jowell, "Implementation and Enforcement of Law", supra note 169, chapter 6 at p 290: "These purely legal questions are important but leave many questions unanswered that are the concern of the organizational and political theorists, who in turn tend to neglect the legal dimension. The first is that of nonlegal constraints on discretion - the long list of factors which, through various empirical studies, we know influence organizational behaviour. These include the constraints of resources, time, professional norms, hierarchy, and incentives."

For a useful discussion of discretionary justice in the UK context see Baldwin and Hawkins, "Discretionary Justice: Davis Reconsidered" [1984] Public Law 570.
making process often underestimate the significance of the collective nature of much administrative decision making.\textsuperscript{179}

Other writers have pointed out that a legal grant of discretionary power is not always synonymous with the ability to make discretionary decisions in practice.\textsuperscript{180} Lacey has observed that officials who might be thought to occupy quite a lowly position in the bureaucratic hierarchy, with little ostensible discretion, may often exercise a good deal of discretionary power in practice. She cited the example of clerks who act as "a filter for sending cases and complaints on to the next stage of the process."\textsuperscript{181} A switchboard operator answering the telephone in a police station and deciding where to direct particular complaints might well fall into this category.

4.8.3 Adjudication as a Rule-Based Concept

The above distinction becomes important when considering the difference between rule making and adjudication in the administrative context, a distinction which has been developed in detail in the United States. Where an individualised exercise of administrative discretion is required, accompanied to a greater or lesser degree by observance of principles of natural justice such as the provision of a hearing, the processes required are likely to differ considerably from a situation where it is

\textsuperscript{179} Hawkins, \textit{ibid}, 178, p 27: "Discretion is also often regarded as a feature of decision-making by individuals. This, too, is not surprising, since individuals or panels of individuals are often allocated formal authority to make legal decisions. Decision-making in law is, however, to a greater extent than is apparent from much of the literature, a collective enterprise. Indeed, it is hard in reality to sustain the idea of the individual actor exercising discretion according to legal rules or standards alone, unencumbered by the decisions or influences of others." See also McLachlin (now Madam Justice McLachlin of the Supreme Court of Canada), "Rules and Discretion in the Governance of Canada" (1992) 56 Sask LR 167 at 172: "Just as the law fails to conform to the stereotype of rigid rules, administrative decision-making fails to conform to that of arbitrariness. The stereotypical character involved in administrative decision-making is a harried, blue-shirted (male) bureaucrat, with his tie undone, hair askew and blood shot eyes, barely visible above a foot-deep pile of files, clearing his desk at 4:30 in the afternoon on a day he would rather be playing golf... In fact, reality is much more complex. Usually there is more than one decision-maker. Often decision-makers are persons of great expertise and experience, able to assess the important features of a case much more quickly than would a judge who lacks their special experience."

\textsuperscript{180} See Lacey, "The Jurisprudence of Discretion: Escaping the Legal Paradigm" in Hawkins (ed), \textit{The Uses of Discretion, supra} note 178, chapter 11, pp 380-387.

\textsuperscript{181} \textit{Ibid} p 381.
permissible to reach the decision by the application of known rules, albeit where those rules are construed in a purposive or practical fashion.\textsuperscript{182} The primary usefulness of a rule making regime in the administrative context is therefore in the limiting and structuring of discretionary decisions, a concept which is of particular application in the regulatory arena.

One of the better analyses of these issues in recent times has been that of Professor Schauer in his book on the subject published in 1991.\textsuperscript{183} In this book, Schauer analyses the philosophical and jurisprudential nature of legal rules and examines the way in which rules serve an allocative function in relation to decision making power. He also considers the conceptual basis for the two accepted models of dispute adjudication, the first being where the adjudicator has an unrestricted or unfettered discretion to evaluate all the relevant circumstances when reaching a decision and the second being where the decision maker is constrained by rules in reaching a conclusion in any particular case. Schauer traces the pedigree of this analysis back to Weber's classic formulation of "charismatic" as opposed to "empirical" justice.

Weber postulated that "kadi-justice", invoking the picturesque image of the learned elder dispensing justice under the palm tree in the village square or in some other public forum, represented an informal system in which the role of tradition was limited and in which the charismatic figure gave judgment in a practical fashion, almost by a process of revelation or inspiration. (In this sense, Weber's conception of the kadi bears some resemblance to the once-popular theory of the common law judges as priest-like figures revealing common law doctrines which had always existed by some kind of almost mystical process, a perception which has undergone some revision in these more prosaic times.\textsuperscript{184}) This notion Weber saw as being opposed to a system which proceeded in an empirical fashion through reliance on analogy and the interpretation of

\textsuperscript{182} As Jowell puts it at note 167, \textit{supra}, at p 180: "The legal techniques for controlling discretion are those of rules, which 'legalise' decisions, and adjudication, which provides a forum for the 'judicialisation' of decisions."


\textsuperscript{184} See for example Lord Reid, "The Judge as Law Maker" (1972) 12 JSPTL 22, for a judicial view disparaging of this earlier mythology.
prior precedents. In any non-bureaucratic system the demarcation between these two models was often not absolute, in Weber's view.185

Applying Weber's models of adjudication to the rule making context, Schauer takes the view that it would be possible in theory for government to function through allowing subordinate officials an essentially uncontrolled discretion (so that each official could reach an individual decision unfettered by either rules or precedents, in much the same way as Weber's kadi was supposed to operate.) However the exigencies of modern government, coupled with the democratic necessity of treating like cases in a like fashion have inevitably meant that the modern administrative state (as opposed to an idealised bureaucracy staffed by officials of surpassing individual wisdom) has tended to avoid adjudicative models of this kind.

While Schauer recognises that rule based decision making may be a less than ideal system (or suboptimal as he puts it), in that perfection in decision making in the individual case may foreseeably be sacrificed in favour of expediency and convenience in order to facilitate the processing of a large number of cases, such an outcome may be difficult or impossible to avoid in practice in the circumstances of modern governmental decision making.186 To this extent, Schauer asserts that rule based decision making may not necessarily be just in the abstract sense, as although it may lead to consistency, it may also fall short of the results achievable under a perfect system of individualised adjudication.187

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185. Weber, Essays in Sociology, supra note 19, pp 216-217: "Kadi-justice knows no reasoned judgment whatever. Nor does empirical justice of the pure type give any reasons which in our sense could be called rational. The concrete valutational character of Kadi-justice can advance to a prophetic break with all tradition. Empirical justice, on the other hand, can be sublimated and rationalized into a 'technology'. All non-bureaucratic forms of domination display a peculiar coexistence: on the one hand, there is a sphere of strict traditionalism, and, on the other, a sphere of free arbitrariness and lordly grace. Therefore, combinations and transitional forms between these two forms are very frequent ..."  

186. See Schauer, supra note 183, at p 101, who notes: "If over a run of cases falling under a rule most results will be the same but no better than the results that would have been generated absent the rule, but some of the results will be worse than the results generated absent the rule, the aggregate results will fall short of an aggregate optimum defined in terms of the accumulation of best results in each case. Thus, for a run of cases, rule-governed adjudication will be suboptimal, failing to achieve the ideal of reaching the best result on every occasion."

187. Ibid p 137: "Insofar as factors screened from consideration by a rule might in a particular case turn out to be those necessary to reach a just result, rules stand in the way of justice in those cases and impede optimal justice in the long term. We equate Solomon's wisdom with justice not..."
Schauer himself accepts that his analysis is an idealised one, in the sense that it approaches the subject from a theoretical, as opposed to a practical, perspective.\textsuperscript{188} Both experience and observation suggest of course that modern administrative decision making is not undertaken under ideal conditions. Frequently the number of cases to be dealt with and the less than adequate resources devoted to the administrative task mean that the giving of Solomonian consideration to each individual circumstance is, and conceivably always will be, an elusive ideal rather than a practically achievable goal.

Similarly it is a fact of modern life that administrative decision makers vary greatly in their individual qualifications for the task, in areas as diverse as intelligence, diligence, educational qualifications and level of interest in and aptitude for the job. Furthermore an individual bureaucrat, being only human, can suffer from an off day, or can be motivated by irrelevant or extraneous considerations such as dislike for a particular applicant, or alternatively undue sympathy for an applicant. He or she may also seek to reach a decision based on self interest, possibly reflected in the prospects for personal career advancement or a desire not to 'rock the boat'. The demands of the modern democratic state for like cases to be treated in a like manner (especially in areas of social and economic regulation, such as entitlement to welfare benefits, provision of state funding in various areas and licensing issues) also mean that reliance, to a greater or lesser extent, on a rule making regime as the basis for administrative decisions becomes almost inevitable.

Schauer recognises that a system of administrative decision making inevitably needs to cater for imperfections in the system itself, both in relation to the quality of the decision makers and the adverse consequences which can result from inconsistent decisions.\textsuperscript{189}

\begin{flushright}
because Solomon followed rules in resolving custody of the baby, but because he came up with exactly the right solution for that case. Frequently the goals of justice are served not by the rule-followers, but by those whose abilities at particularized decision-making transcend the inherent limitations of rules."
\end{flushright}

\textsuperscript{188.} As Schauer notes in his preface at \textit{ibid} p vii, his book is "an exercise in analytic isolation, which is to say that it is deliberately and unashamedly 'unrealistic'."

\textsuperscript{189.} \textit{Ibid} p 153: "When we choose rules, and thus when we choose the option of the second-best, we focus on the worst of any array of decision-makers for we worry more about decision-maker error than about the errors that are built into the rules themselves. Consequently, the choice of rule-based decision-making ordinarily entails disabling wise and sensitive decision-makers from making the best decisions in order to disable incompetent or simply wicked decision-makers from making wrong decisions. Conversely, a decision procedure that avoids or diminishes the
Implicit in all of these considerations, as Schauer himself observes, is the fact that rules have a discernible influence on the allocation of decision making power. To return to Weber's archetypal example, the *kadi*, in his pre-eminent position under the village palm tree, has unfettered decision making power, whereas the typical bureaucrat, operating under a framework of close-knit Weberian rules, may have limited residual scope for the exercise of individual discretion.

This argument of course applies not only to administrative and regulatory decision makers but also to the judiciary. While a High Court judge might arguably, at least from the perspective of decision making quality if not efficiency, make a better job of the task of allocating social welfare benefits through individual decisions made in the context of the court process than the results which a junior bureaucrat might achieve administratively, this begs several questions (apart from solely logistical and economic ones). One of the most significant of these is the notion of democratic accountability, as Schauer notes. 190

Looking at the matter overall, Schauer recognises that rule making can serve an indispensable function in the context of the modern administrative state where expediency and volume of decision making inevitably have to be balanced against the achievement of the best (or optimal) result in any particular case. A rule making regime undeniably has the effect of fettering individual adjudicatory discretion in the interests of maintaining the integrity of the entire decision making system on a practical level. The use of rule making in this way can hardly be criticised as a result. While in an ideal world all decision making of a public character would be carried out by a *kadi*-like figure, in practice we have to be content with a lesser standard. The use of administrative rule making helps to ensure that such a standard does not become

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190. *Ibid p 159:* "Rules therefore operate as tools for the *allocation of power.* A decision-maker not constrained by rules has the power, the authority, the jurisdiction to take everything into account. Conversely, the rule-constrained decision-maker loses at least some of that jurisdiction...The traditional theory of judicial authority, under which legislatures make the rules and judges apply them, is not based nearly as much on a fear that judges will make errors in the process of engaging in open-ended decision-making as it is based on the assumption that determination of questions of substantive value should be for popularly responsible and responsive institutions such as legislatures, and not for non-majoritarian institutions such as the judiciary."
unacceptably low. It also avoids an undemocratic concentration of power in the hands of the decision maker, an argument which is applicable to both judicial and administrative decision makers.

4.8.4 Legislative and Administrative Rules

As noted above, administrative rules may have legislative attributes. It is not difficult to find a number of examples of rules made by administrative agencies which fit this description while not formally amounting to delegated legislation in the usual sense of that term.191 This phenomenon has long been recognised. Harold Laski was attuned to the issue in 1925.192 Sir Ivor Jennings, writing in 1933, noted that the distinction between legislation and administration was not a precise one, observing that many general rules of a similar nature to statutes were promulgated by bodies other than Parliament.193

Jennings went on to observe that the level of generality of application of statutes and rules was also an unreliable guide to the demarcation between legislative and administrative processes. This was particularly the case given the existence of special Acts of Parliament of specific application to defined persons or particular situations and the existence of rules and orders of general scope, which might not be in the form of

191. See for example Jowell, supra note 167 at p 185, who notes: "An organisation charged with implementing vague legislation will itself be an agent in the clarification and elaboration of legislative policies. In this sense, bureaucracies are surely law makers themselves (Weber's picture of mechanical enforcement notwithstanding)."

192. See Laski, A Grammar of Politics (George Allen & Unwin Limited, London, 1925) at p 388: "What is always typical of the modern State is that, over and above the general law-making authority, there will be found a number of subordinate authorities with the power to bind citizens as though they were making statutes."

193. Sir Ivor Jennings, The Law and the Constitution (University of London Press, London, 1933) at p 12: "We do know what legislation is, because it is enacted by Parliament in accordance with a traditional form. But there may be general rules which are not enunciated by Parliament. For instance, local authorities are bound to grant poor relief to any poor person who is not able to maintain himself. The individual cases are dealt with in a county by a special guardians committee. But that committee is controlled by the public assistance committee of the county council which issues general orders to its guardians committees; the public assistance committee receives general orders from the council; and the council receives general orders from the Minister of Health. Each of these general orders is a general rule, and therefore is of strictly the same nature as an Act of Parliament."
published delegated legislation. In the United States context, by comparison, the concept of administrative rule making as being to all intents and purposes a legislative process has now been largely accepted. However this position was not achieved without a good deal of constitutional soul-searching, which was not only confined to the New Deal era of the 1930s.

4.8.5 UK Experience with Rule Making

In Britain rule making activity has tended to take various forms. The use of codes of practice, for example, grew in popularity during the 1970s as noted in part 4.2.1 of this chapter. Codes have also been developed in the financial services area, particularly in relation to the activities of the Stock Exchange (of which the most important example is the City Code on Takeovers and Mergers.)

Areas such as securities transactions, the advertising industry, the newspaper industry, the supply of goods and services and insurance contracts also been the subject of codes

194. Jennings asked the rhetorical question, supra note 193 at p 14: "Is it legislation when a sanitary inspector orders the dustmen under his control not to accept Christmas gifts from householders?" In his view the answer (at p 18) was as follows: "So long as the administrative authority lays down general rules it is, as I have explained, performing an essentially legislative function. So long as it is taking a decision in a particular case, it is exercising the same function as a judicial authority, though not necessarily in the same way."

195. See for example Shapiro, "APA: Past, Present and Future", (1986) 72 Virg LR 452 at 453-454, who noted that the effect of the US Administrative Procedure Act has been to create three categories of administrative procedure: legislative rule making, judicial adjudication and truly administrative tasks. Kerwin, in his recent book on administrative rule making, Rulemaking, How Government Agencies Write Law and Make Policy (CQ Press, Washington DC, 1994) expressed the view at p 50 that: "In the simplest terms, the APA requires agencies to behave like a legislature when they write rules and like courts when they adjudicate disputes."

196. The hostile judicial treatment of Roosevelt's New Deal legislation in the United States, on the basis that it amounted to an unconstitutional delegation of legislative power, is described in chapter 6. In more recent years concerns have resurfaced that the broad powers of the administrative regulatory agencies are so far reaching as to constitute an unauthorised delegation of legislative power, even after the passing of the Administrative Procedure Act of 1946. See for example Anderson, "Revisiting the Constitutional Status of the Administrative Agencies" (1987) 36 Am ULR 277; Sunstein, "Constitutionalism after the New Deal" (1987) 101 Harv LR 421; Lawson, "The Rise and Rise of the Administrative State" (1994) 107 Harv LR 1231. This issue will be explored further in chapter 6 when the US regulatory system is examined in more detail.

Baldwin has employed the term "tertiary rules" to refer to less formal types of rules such as codes of practice so as to distinguish them from secondary rules (which he has defined as delegated legislation issued pursuant to a statutory power and having legislative effect) and primary rules (contained in Acts of Parliament.)

One of the principal objections to the use of the more informal kinds of delegated legislation such as codes of practice, departmental circulars and similar techniques relates to their insulation from parliamentary scrutiny and the fact that they can be introduced (barring specific statutory requirements to the contrary) with minimal, or indeed no, consultation with affected parties. The key to greater academic and judicial acceptance of administrative rule making techniques in the United Kingdom context (and also in other Commonwealth jurisdictions) lies in no small measure in devising an acceptable solution to these perceived difficulties.

Baldwin has summarised the perceived problems with tertiary administrative rules in terms of lack of legislative mandate and problems with Parliamentary accountability and control. Many of these difficulties, such as legal uncertainty and lack of accountability and Parliamentary control, could be addressed by the provision of a structured basis for the consideration and adoption of such rules. This is a matter which will be considered further in subsequent chapters.

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199. Baldwin, "Governing with Rules: The Developing Agenda" in Richardson and Genn (eds), supra note 142, chapter 7.

200. Ibid p 168: "On examination it appears that many of the problems of legitimation that are encountered with secondary legislation apply all the more in relation to tertiary rules. Thus, to claim that tertiary rules implement the legislative mandate is problematic not simply because the mandate is generally not present in any explicit form but because the legal effects of tertiary rules are highly uncertain.... As for the claim that tertiary rules can be justified on the basis that their makers are accountable, this may be weaker still. Such rules may be couched in language that is accessible but they are free from general statutory controls as to modes of promulgation. Parliamentary control is also lacking and hardly seems feasible given the constraints that already render the scrutiny of secondary legislation unsatisfactory."
4.9 Some Conclusions on Regulatory Techniques

Some conclusions can now be drawn on the efficacy of the regulatory techniques discussed. To begin with agency regulation, this has its strengths and weaknesses, but it is noteworthy that most western economies have found it necessary to make use of the concept to a greater or lesser extent in many facets of economic and social regulation, with the United States being the leading proponent of the technique.

Agencies can of course vary considerably in their structure, powers and degree of regulatory independence, as the discussion above has shown. However, their usefulness and expertise in tackling complex regulatory issues should not be underestimated, as the less than satisfactory New Zealand experience with market entrants seeking interconnection to networks operated by a natural monopoly supplier, such as the dominant telecommunications firm, graphically illustrates.

Many of the problems and criticisms with agency regulation can be reduced or eliminated by carefully designed organisational structures, clear legislative mandates and flexible yet enforceable regulatory powers. Agency regulation is clearly far from perfect but in terms of general responsiveness and flexibility it scores rather more highly than opposing regulatory techniques. In a regulatory system which places legitimate emphasis on public participation and on balancing the interests of competing groups, a body which can assess all of these variables in the light of an overall policy structure is likely to prove indispensable to the attainment of better economic regulation.

The above perspective is reinforced when the alternative techniques discussed above, such as franchising/contracting, taxes, subsidies and tradeable permits, negotiation and bargaining and reliance on the general competition law are considered. The discussion in this chapter has shown that these techniques may be useful in certain areas and can excel in particular applications. However they are in general too narrowly focused or specialised to constitute an adequate regulatory regime in themselves.

In certain cases, as in franchising/contracting and reliance on general competition law, the economic assumptions underlying the use of these techniques are too often either not fulfilled or else are totally lacking in practice. Compelling firms to behave in a
way which is detrimental to their immediate financial interests cannot always (or indeed perhaps ever) be achieved by appealing to their better nature or by quoting (or preaching) to them from economics text books. Achieving regulatory goals sometimes necessitates the approach advocated by Theodore Roosevelt of speaking softly and carrying a big stick.\footnote{To be precise: "Speak softly and carry a big stick; you will go far." (Speech by Theodore Roosevelt in Minnesota, 2 September 1901), quoted in Cohen (ed), \textit{The Penguin Dictionary of Quotations} (Penguin Books, London, 1967), p 299, paragraph 13.}

The use of self-regulatory techniques in conjunction with external regulation represents a means of placating critics of government intrusion into economic affairs. By allowing industry bodies greater latitude to set their own rules and to enforce compliance with them, the legitimacy of the regulatory process might be enhanced. Such processes do of course have their own dangers, such as the possibility of a regime which favours the interests of the regulated firms against that of the public and which is lacking in constitutional accountability and legitimacy. However these objections can be countered to a large extent by employing well designed structures which operate in conjunction with concurrent government regulatory supervision.

The general objective of the present exercise has been to develop a regulatory structure which is best suited to the implementation of the regulatory theory to be developed in the following chapter. To this end, the above discussion of the strengths and weaknesses of various regulatory techniques will shortly be applied.
APPENDIX I: An Illustration of the Use of Rules and Discretion

The problem with rules...

The problem with discretion...
5. TOWARDS AN IMPROVED MODEL OF ECONOMIC REGULATION

5.1 Introduction

This chapter is concerned with developing an improved model of economic regulation. This model is based on the central principle that the only legitimate form of external economic regulation in a democratic system is one which allows for competing interests in the regulatory process to be assessed and balanced in a structured way following full consultation and participation by all parties involved in the process of regulatory decision making.

In approaching this task, it is worth bringing to mind the justifications for economic regulation which were advanced in part 1.9 of chapter 1. It will be recalled that these were closely based on economic arguments. Such arguments included the need to control monopoly power and excessive profits, correct for externalities, protect third parties such as consumers, compensate for inadequate information and eliminate excess or inequitable competition. As the discussion in the preceding chapters has shown, the need for economic regulation is closely bound up with the potential damage which might result to the public interest if potentially abusive market practices were left unchecked.

Regulation in the public interest is a common feature of most modern western economies, even though the approach taken in various individual jurisdictions differs. In the United Kingdom, economic regulation, as will be discussed in chapter 7, relies heavily on a system of single industry regulators in relation to the privatized utilities and rail transport. However, the commission structure can also be found in areas such as civil aviation, the regulation of commercial television broadcasting and financial services. In the United States, by way of contrast, economic regulation is almost exclusively centred around the various independent regulatory commissions, as will be examined in chapter 5. Commonwealth jurisdictions evince an approach between these two extremes. In countries such as Canada, Australia and New Zealand, the use of agency regulation is accompanied by reliance on the general
competition law to a greater or lesser degree. As has been seen, the New Zealand regime possibly represents the most light-handed approach in these jurisdictions.

As the discussion in chapter 2 showed, the concept of a business affected with the public interest was closely associated historically with the provision of services in monopoly or near-monopoly situations. The common law imposed the twin requirements of universal service at a reasonable price in such cases. It is this feature (a significant element of monopoly supply in a particular market) which distinguishes industries such as the privatized utilities and rail transport from more general commercial activities, such as supermarkets, travel agents, hairdressers and the provision of professional services. However, where in these other industries an element of market dominance can be shown to exist, similar public interest arguments arise. Thus if the major supermarket chains, oil companies or car manufacturers could be shown to be colluding in areas such as pricing and service, then public interest considerations would dictate state regulatory intervention into their business activities.

Acceptance of the need for regulation in the public interest of course begs the question of how the public interest is to be assessed and how the interests of competing groups are to be reconciled. While the public interest might popularly be identified with the interests of consumers, some further reflection shows that other sections of the public, such as employees, employers, shareholders and specialised interest groups also have a legitimate involvement in regulatory outcomes. Each of these groups has a different interest or stake in the regulatory process and the comparative weighing of these interests does of course involve political and economic considerations as well as legal ones. This chapter posits the theory that the interests of such groups can be reconciled through a mechanism which permits each of them to participate fully and fairly in the processes of regulatory decision making.
5.2 Reconciling Differing Interests in the Regulatory Process.

5.2.1 The Implications of Economic Arguments Such As Public Choice Theory

In developing a improved model of regulatory intervention, some consideration needs to be given to the political and economic context in which regulation functions. As has been noted in the preceding chapters, differing political and economic philosophies give rise to varying regulatory outcomes. We have seen that public ownership, for example, which in terms of philosophy has traditionally been closely related to collectivist theories of political organisation, has its own particular strengths and weaknesses. The strengths include the possibility of allowing for co-ordination by government at the level of both policy and practice and promoting the recognition of social goals. The weaknesses can include lack of accountability in decision making, a conflict between commercial and social objectives and a possible lack of efficiency in certain areas. As was noted in chapter 3, the debate on many of these aspects, particularly the latter, remains open.

On the other hand, the present period of widespread privatisation and reliance on market forces is closely linked to political and economic theories which stress the importance of market processes in economic management. Public choice theory, which is one of the more prominent examples of these, emphasises the fact that individuals and groups seek to act in their own self-interest, so as to maximise their individual utility in a rational manner. The theory contends that such behaviour will be manifested not only by economic entities such as firms, businesses and consumers, but also by participants in the political process, such as voters and politicians.

Theories of public choice assume that it will be difficult, if not impossible, to obtain a workable consensus in relation to the setting of government social and economic policy and that the best solution to this problem is to encourage the maximum use of market-based structures which recognise and encourage self-interested action as the behavioural norm. Accordingly, public choice theory tends to deprecate public and mixed public and private forms of ownership on the basis that all forms of state intervention or involvement in commercial activity are inherently suspect. The link between public choice theory and the favouring of private, or privatised, ownership structures therefore becomes obvious. The focusing of commercial activity in private
hands reduces government involvement in business and industry. Those individuals who wish to invest in private enterprises can further their own self interest by doing so, and, so the theory contends, the returns from their investment ought to be largely unaffected by government action (or, for that matter, by extraneous welfare concerns.)

The adherents of public choice theory necessarily tend to endorse the effectiveness of market processes as reflecting their preference for rationally self-interested behaviour. However, taking a wider perspective, markets are not necessarily either truly competitive or free from various imperfections, as has been noted in previous chapters. Earlier discussion has shown how this situation is illustrated by the two extremes of uninhibited, cut-throat competition and the drive on the part of powerful firms to either attain or preserve a position of market dominance.

Furthermore, private ownership need not necessarily lead to comparatively greater efficiency than public ownership, particularly where competition is absent or where the structure of the particular industry concerned does not lend itself to the achievement of this goal, as the analysis of the UK privatised rail industry in the previous chapter has shown. It is of course possible at the theoretical level to support market institutions without necessarily adopting the public choice approach, as recent intellectual efforts by Gray and others have shown.

Irrespective of the merits and demerits of public choice and other similar market-centred theories, a political debate which is beyond the immediate scope of this thesis,


2. See the discussion of the UK local bus industry in part 7.5 of chapter 7 and of US domestic air transport in part 4.6.1 of chapter 4.

3. See the discussion in part 4.6.1 of chapter 4.

4. See the discussion in parts 4.3.3 to 4.3.4 of chapter 4.

5. See Gray, The Moral Foundations of Market Institutions (IEA, London, 1992). Gray notes at p 91: "The real space for public discourse is not between the two extremes [of libertarianism and egalitarianism], but in the area of detailed debate about the scope and content of public goods, the depth and limits of the common culture, the relative costs of government failure and market failure, and the content and levels of provision of basic needs."
some consequences of adherence to such theories are clear. In placing stress on individual choice and the unrestrained ability to seek self-interested goals, theories of this kind necessarily tend to recognise as the norm such behaviour on the part of private firms. Thus, an unrestrained (or extreme) public choice approach would tend to favour complete absence of government regulation, even where market failures exist. It would also support the interests of shareholders in private firms seeking to maximise their returns on investment, and the interests of management in maximising the profit of their firms (as well as their own income, which is often linked to levels of profit performance as the contemporary UK experience in this area notoriously illustrates.)

It is therefore unsurprising to find that public choice theory, when applied to privatised ownership structures, tends to favour the interests of shareholders in firms at the expense of those interest groups whose bargaining power is comparatively less. These other groups might typically include employees, consumers and supporters of collateral interests, such as environmental protection and social welfare. Indeed, considerable recent academic analysis has been undertaken linking the rise of the privatisation movement to political factors, such as the accompanying strength and ascendancy of an independent middle class of share owners. This is a conclusion which would no doubt have been unsurprising to earlier generations of collectivist thinkers, who looked upon the proletariat (approvingly) and the bourgeoisie (disapprovingly) as two of the fundamental components of society.

All of this illustrates that philosophical support for private ownership in itself, based on ideologies such as public choice theory, is not likely to furnish the basis for a regulatory theory which satisfactorily reconciles differing interests in the regulatory process. Under a system in which investors in the market and in market enterprises, as well as the proprietors of firms operating in the market, are encouraged to pursue their own unmitigated self interest, and are also given the means to do so, the predictable result will be that the interests of those parties will predominate and override other legitimate interests. This is all the more probable where external regulatory intervention is

6. For a discussion of this phenomenon see Feigenbaum and Henig, "Privatization and Democracy" (1993) 6 Governance 438.
discouraged and there is little incentive to develop a model which seeks to balance or reconcile other interests in the regulatory process.

5.2.2 A Stakeholder Approach to Regulation

(i) The Need for a Stakeholder Approach

Even within a system of widespread private ownership, public choice theory and its accompanying emphasis on self-interested behaviour are not the only explanatory models in evidence. There has recently been much discussion of "stakeholder" based approaches, whereby the various participants in the regulatory process are viewed as having legitimate interests which should be balanced and reconciled as far as possible. Souter, for example, who has advocated such an approach in a recent essay, argues that the interests of seven major stakeholder groups should be taken into account. He identified these groups as customers, shareholders, management, competitors and potential competitors, suppliers of equipment and services, employees and the government itself.

Souter went on to examine in his essay the respective interests of the various stakeholder groups. In relation to consumers he noted that the interests of different categories of consumer (particularly residential and business customers, and those in urban and rural areas) were not necessarily identical and that any regulatory policy seeking to take account of customer interests should reflect this diversity of

7. See for example Lewis, *Choice and the Legal Order: Rising above Politics* (Butterworths, London, 1996), chapter 9, arguing that the state has the right to regulate corporate and financial institutions so as to enforce minimum standards of obligation towards stakeholders such as employees, customers and consumers. See also essay in *The Independent*, 5 February 1996, by Hampden-Turner, "The enterprising stakeholder".


9. *Ibid* p 36: "Each of these stakeholder groups has particular interests, which are not necessarily compatible with one another. Indeed, there are substantial differences of interest both between them and within some categories - as for example, between less profitable residential and more profitable business customers. Each stakeholder group's interests, and the different weighting that may seem appropriate to it, will also vary over time - for example as the degree of competition in a market develops."
involvement. The primary interest of consumers in the regulatory process was to achieve the best attainable levels of pricing and service.

In the case of shareholders, Souter noted that they sought to maximise their return on investment as a universal general principle regardless of the type of firm in which they had invested (whether it was a privatised utility or any other kind of commercial enterprise). In the case of investment in firms which were natural monopolies, or which retained some of the features of natural monopoly, the shareholders' interest was generally in encouraging weak regulatory regimes, thereby allowing firms to generate a high rate of return to investors while maintaining the maximum attainable market share and level of profitability. To this extent the interests of shareholders were opposed to those of consumers.

So far as management was concerned, it could be expected to seek maximum returns for shareholders so as to ensure the commercial success of the enterprise. This objective was of course not entirely altruistic as such a result was likely to be personally rewarding to the executives of firms both in terms of career advancement and individual financial reward, given that remuneration packages for senior management staff were frequently closely related to the financial performance of their firms through share options, bonus schemes and similar benefits.

As Souter noted, these objectives might conflict with other priorities (such as efficient and universal customer service), a factor which has contributed in no small measure to the current public hostility toward what are perceived to be excessive levels of executive remuneration, particularly in the privatised utilities. It is certainly difficult to sympathise with large remuneration packages for senior executives of a privatised water company whose customer service levels are so deficient that it attracts a £40m penalty from OFWAT as a consequence, or with the salaries and perquisites of their

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10. As is illustrated by the case of the recent tribulations of Yorkshire Water and its well-publicised mishandling of events during the summer drought of 1995. See for example an article in the Independent on Sunday, 4 February 1996: "Profit and loss", recording that one Yorkshire Tory MP, Sir Donald Thompson, had told the House of Commons on Tuesday, 30 January 1996, that he had received more correspondence during the summer of 1995 complaining about the failings of Yorkshire Water 'than on the community charge and the Child Support Agency put together.'
counterparts at British Gas, whose levels of consumer service during 1995 were so poor that it could not maintain its Chartermark accreditation.

The question of how to address this issue is more problematic. At the wider level it can be viewed as an aspect of the growing wealth and income disparity in society as a whole, a phenomenon which is not unique to Britain by any means. Modern statistics on income disparity in Western economies, such as those set out in the preceding footnote, would certainly have astounded early thinkers such as Plato, who envisaged that an ideal distribution of wealth from the richest to the poorest members of society ought not to exceed a ratio of four to one!

Some commentators regard greater disclosure of directors' benefits as providing a potential solution, although British experience to date with aggrieved shareholders attempting to vote down lucrative executive remuneration packages at company general meetings has not been particularly encouraging. It may be that specific legislation


12. For some revealing contemporary statistics see article by Whittam Smith in The Independent, 19 August 1996: "Close the wage gap or everyone will suffer": "In all advanced economies the rich are getting steadily further ahead. In Britain the gap between the highest and lowest male wage rate is at its highest since the 1880s. In the United States the average boss is earning 120 times what the average worker takes home; 20 years ago the ratio was 35 times."

13. See Plato, Laws V, 744e, in The Collected Dialogues of Plato including the letters (E Hamilton and H Cairns (eds), Bollingen Series LXXI, Princeton UP, Princeton NJ, 1963), pp 1328 - 1329: "So let the limit on the side of penury be the value of an allotment ... The legislator will take it as a measure, and permit the acquisition of twice, thrice, and as much as four times its value. If a man acquires further possessions, from treasure-trove, donation, or business, or by any other similar chance makes acquisitions in excess of this measure, he may retain his good name and escape all proceedings by consigning the surplus to the state and its gods."


15. In three recent cases where concerted opposition was mounted by private shareholders to executive remuneration packages in the privatised utilities both initiatives were defeated by the proxy votes of large institutional shareholders. See the discussion of the British Gas Annual General Meeting on 31 May 1995 in part 7.4.6(i) of chapter 7, the generous directors' incentive plan approved by a majority of the shareholders of United Utilities in July 1996 (The Times, 27 July 1996) and the concerted opposition by 200 investors to a controversial directors' share incentive scheme proposed by Yorkshire Water at its Annual General Meeting on 10 July 1997.
will provide the only conclusive solution in this area.\textsuperscript{16} The present Labour government, when in opposition, foreshadowed various initiatives, legislative and otherwise, to curb excessive directors' remuneration, including more stringent disclosure requirements and compulsory shareholder approval at annual meetings for board level remuneration packages.\textsuperscript{17}

However, it should be noted that the electricity regulator achieved a measure of success during 1996 by factoring foreseeable cost savings from lower directors' remuneration into his pricing review of the National Grid Company.\textsuperscript{18} (Judging by the veritable howls of protest from the company's board an uncharitable observer might be tempted to the view that the required cost savings will, however, be more likely to be achieved through reductions in staff and operating expenses rather than by reducing directors' remuneration.\textsuperscript{19}) The prospects for voluntary restraint or effective self-regulation being exercised in this area by persons with a direct (and extremely lucrative) financial stake in the decision making process would seem to be less than miniscule.

\textsuperscript{16} For an expression of this view see Villiers, "Directors' pay in the utilities: an ill not yet cured" (1995) 6 Util LR 100. The woeful level of voluntary compliance with the Cadbury and Greenbury codes of best practice in corporate governance has been revealed by research recently submitted to the Hampel Committee on Corporate Governance. See article in \textit{The Times}, 6 January 1997: "Most directors fail to meet codes of best practice on pay". An article in \textit{The Times} of 30 December 1996, "Boardrooms 'too biased towards the shareholders' ", reported the centre for tomorrow's company, established by the Royal Society for Arts, as having submitted to the Hampel Committee that directors' duties should be regarded as being owed to the company broadly and not to any specific third party group such as shareholders.

\textsuperscript{17} See the proposals outlined in \textit{Vision for Growth - a new industrial strategy for Britain} (Labour Party publication, September 1996); article by Harrison in \textit{The Independent}, 19 August 1996: "Labour to curb pay in the boardroom."

\textsuperscript{18} See article in \textit{The Times}, 14 August 1996: "Regulator condemns pay levels at Grid."; article in the \textit{Financial Times}, 14 August 1996: "Grid faces tough price controls."

\textsuperscript{19} The attitude of the NGC board to date in this area gives little cause for optimism. When the company was floated in 1995 the directors approved a generous share option structure and substantial dividend payments, despite the prospect of a national electricity shortage arising shortly afterwards. A long term incentive plan of even more generous proportions was unveiled in July 1996 to a storm of protest from various quarters. In response to the regulator's view that executive remuneration at NGC exceeded the industry average the company's managing director simply retorted that this was an "absolutely extraordinary statement." (See \textit{The Times} article in note 18, supra.)
The issue of executive remuneration becomes all the more troublesome when the individuals in question have not infrequently attained their present position through the good fortune of being in the right place (a natural monopoly) at the right time (privatisation), while showing little sign of having been harassed by international headhunters on account of their outstanding management skills while their companies were publicly owned. Indeed recent experience with firms such as some of the privatised water companies has been suggestive of gross managerial incompetence rather than high levels of executive flair and excellence.

While the public may be prepared to live with or even applaud the wealthy self-made entrepreneur, the millionaire who has attained that status through the vehicle of a natural monopoly with suspect pricing structures and appalling customer service levels attracts a somewhat different response, and understandably so. The admiration (perhaps grudgingly) reserved for a Richard Branson is unlikely to be extended to the directors of Yorkshire Water by its hapless customers (at least during the summer of 1995.) In the United States, where consumers are more vocal in regulatory proceedings and mechanisms exist allowing them to exert a more meaningful interest, utility companies have tended to adopt the position that lucrative executive remuneration packages are not worth the political storms which they inevitably generate. This has especially been the case where the companies in question have also sought rate increases from the relevant regulatory body at the same time. All of this reinforces the central importance of structured methods of participation.

20. See article in *The Economist*, February 25, 1995, p 99: "Power Politics, American style": "...high prices increase the political pressure on companies: in states where prices are high, such as California and New York, consumer groups are more vociferous in regulatory proceedings. For the same reason, the faster a utility's prices rose, the less eager it was to raise its bosses' pay. Salaries were also lower when utilities had a high proportion of industrial customers, who are usually better represented than householders in regulatory hearings. And in states where regulators were perceived to be tough on investors (eg, by allowing low returns on equity) or where they were elected (and so under greater pressure from customers) bosses were less well-rewarded. The presence of an elected regulatory commission cut their pay by an average of 18%." For a recent US study in this area see Joskow, Rose and Wolfram, *Political Constraints on Executive Compensation: Evidence from the Electric Utility Industry* (National Bureau of Economic Research, Washington DC, Working Paper No 4980, December 1994).
(ii) The Different Stakeholder Interests

In terms of regulatory goals, company management has an obvious interest in an efficient and predictable regulatory framework which allows for orderly, long term planning. The management of dominant firms might also be expected to favour weak and unintrusive regulation, in the same way as shareholders, though such a view may not be shared by the management of less powerful competitors, as the case study in chapter 9 of anti-competitive behaviour in the UK telecommunications industry will show.

Competitors and potential competitors have their own interest in the regulatory process. They will also tend to favour an efficient and predictable framework with clear rules as to pricing and investment matters. Where an intending market entrant needs to gain access to an existing transmission or distribution network, as in the case of telecommunications, electricity and gas interconnection, that entrant will need to be assured that there is a workable and efficient means of ensuring that such access is provided on fair and reasonable terms. As noted above, such firms may also tend to favour the availability of strong regulatory powers to deal with anti-competitive behaviour by dominant firms in their particular market.

Suppliers also have an interest in the regulatory process. In their case they are threatened by instability in the market for their equipment and services and will seek some assurance that in any market transition to greater competition, for example, their position will not be jeopardised.

Employees, along with consumers, are perhaps the most vulnerable stakeholders in terms of their position in the regulatory process. In an era of increasing competition and the attendant cost-cutting which often accompanies it, substantial job losses are one of the grimmer realities of the privatisation process, a matter which seems to be a universal phenomenon in all countries which have opted for privatisation and increased competition. In the United Kingdom there has been a loss of over 100,000 jobs in the privatised utilities alone since privatisation began and a similar situation has occurred

21. Souter, supra note 8, p 43. See also Bolton, "Regulation, Deregulation and Labour" in Boulding (ed), Negotiation and Change - Employee Relations in the Regulated Industries (CRI, London, August 1995), chapter 2. In relation to the privatised rail industry in the UK, job losses are forecast among the individual franchisees in the privatised rail network. See for example article
in the United States in the current era of deregulation, particularly in industries such as telecommunications. 22 A disturbing (but not entirely unpredictable) trend amongst some of the UK utilities has been a willingness to blame stringent regulatory pricing regimes for the need for substantial job reductions, even when these were well in contemplation before the relevant pricing review was announced. 23

In terms of their approach to the regulatory process, employees and their representatives will tend not unnaturally to favour regulatory measures which lead to a relatively stable job market. For this reason they may be disposed to favour public ownership, but if this is not a realistically attainable option then they will be inclined to favour a regulatory regime which promotes industry stability and a transition to a competitive market which is as measured and orderly as possible. The interests of employees may foreseeably conflict with those of consumers, in circumstances where price reductions through increased competition or regulatory intervention may lead directly to lower profitability and consequent job losses. However, distinguishing between job losses arising from lower profitability and the ever-present desire on the part of management to save costs by shedding jobs in any event is often problematic in practice. 24

22. See the discussion in Wright, supra note 1, pp 27-29. In the US telecommunications sector over 140,000 jobs were lost during the period January 1993 to January 1996, with the 11 largest companies laying off more than 1,000 workers each, the market leader AT&T leading the field with a figure of 63,500 job losses. AT&T, announced in January 1996 that a further 40,000 of its workers would be laid off over the ensuing three year period as a response to the proposals for complete deregulation of the industry in the United States. See article by Cook and Hetter in the US News & World Report, January 15, 1996: "Hanging up on workers: AT&T will lay off 40,000 to get ready for new competition." In New Zealand, the dominant incumbent, Telecom New Zealand, reduced its workforce from 24,500 in 1987 to around 15,000 in 1991.

23. The most graphic recent example of this was the effort by TransCo management in August 1996 to blame the gas regulator's proposed pricing regime for the need to shed a projected total of up to 10,000 jobs. An internal management report of the transmission company leaked to the press in fact revealed that job losses attributable to the pricing regime were in fact in the order of 2,000, while the company was planning of its own initiative to reduce job numbers by a net figure of some 6,000 in any event over the next six years. See article by Barnett in The Observer, 25 August 1996: "Gas 'misled' over job loss count."; "This means British Gas was planning to operate TransCo with a permanent staff of just over 14,000. In other words, potential job losses stemming from the review will be only 2,000, not the 10,000 Rogerson [the deputy chairman of British Gas] has claimed."

24. The price controls which OFGAS sought to impose on British Gas in May 1996 provide a recent example, as the discussion in note 23, supra, and the accompanying text illustrates. As was there noted, in response to the recent OFGAS pricing proposals British Gas claimed that it would
Employees may also wish to gain a greater input into business decisions by the use of employee share ownership schemes, though in Britain these have met with a mixed reception from both business and from employees themselves. While in opposition the Labour party favoured a policy of more extensive employee share ownership.

Finally the state itself has an interest in the regulatory process in a number of ways. At the political level, governments will obviously be concerned to assess the impact of various regulatory policies on substantial voter groups such as shareholders, consumers and employees. They will also have an interest in promoting the economic efficiency of industry and the maintenance of industrial infrastructure, while at the same time having regard to the social consequences of economic policy. Other considerations, such as the need to obtain tax revenue, the development of a co-ordinated industrial and economic policy and national security implications in terms of the ownership of strategic industries, are also important. The political complexion of a particular government will of course be highly relevant when it comes to assessing the weight to be given to each of these objectives.

The stakeholder concept is one which is currently popular, especially at the political level given the emphasis placed by the present Labour government, when in opposition, need to reduce its workforce by up to half, with the loss of up to 10,000 jobs. The unions representing workers at TransCo, the British Gas pipelines division, joined the company in attacking the gas regulator’s proposals by asserting that a direct effect of the price curbs would be an unacceptably increased risk of dangerous incidents arising from reduced staffing levels. See article in The Times, 12 July 1996: "Unions join attack on TransCo curbs." The fragility of this somewhat unholy alliance was exposed after The Observer published the leaked report referred to in its article of 25 August 1996 (supra note 132). As this article noted: "Mike Jeram, head of the energy division at Unison, said: 'We have always felt that British Gas was playing to two audiences, using the threat of job losses to win support. They have said that they could not operate TransCo on such a low level of staff, and it now seems they are planning to do so anyway.' " British Gas admitted at its extraordinary general meeting in Birmingham on 12 February 1997 to approve its demerger proposals that job losses in the company totalled 35,000 since 1993, 10,000 more than the original target set in 1992. See article in The Times, 13 February 1997: "British Gas job cuts out of control".


26. See article in the Financial Times, 2 May 1995: "Blair signals further cut in union influence - Labour backs wider ownership of shares by employees", reporting on a conference address by Mr Alistair Darling, Labour’s City spokesman, who stated: "We support the case for wider share ownership in general and for share ownership amongst employees in particular."
on a 'stakeholder society', which sought to emphasise the interaction and contribution of differing groups and individuals. It is a concept which is also gaining popularity even amongst right wing commentators who are demonstrating an increasing awareness of the possibility of reconciling shareholder values with other interests. In relying on such an approach in the regulatory context, the degree to which the public interest can be regarded as synonymous with the interests of selected stakeholder groups is obviously an important question. If a mechanism for implementing a stakeholder approach to the regulatory process could be devised this might form the basis for a workable public interest theory of regulation. Further consideration will now be given to these matters.

5.3 A Public Interest Approach to Regulation

5.3.1 Relationship between the Public Interest and Democratic Theory

Most explanatory theories dealing with the nature of the democratic process assume the desirability of encouraging greater citizen participation, although there is a wide divergence of opinion as to how this goal should be achieved. A number of possibilities present themselves here. Involvement in the processes of public policy formation by interest groups and competing factions might be viewed as constituting the most desirable participatory mechanism. A great deal of intellectual effort has been devoted by US political scientists such as Becker and others to demonstrating the relationship between inter-group competition, comparative lobbying power and the

27. See for example article by Lynx in The Sunday Times, 12 May 1996: "How Partnership Pays Dividends: Research shown successful companies serve stakeholders as well as shareholders." For an interesting survey of the performance of major UK firms in this area see Destroying the Myths Surrounding Shareholder Value (Study paper by Strategic Compensation Associates, London, May 1996). An interesting recent contribution to the debate is provided by a book by Professor Kay, The Business of Economics (OUP, Oxford, 1996), who argues that shareholder interests merely have certain specified claims on companies, along with other competing claims. Kay argues (not uncontroversially) that managers of privatised utilities are primarily driven by the desire to meet the needs of customers rather than shareholders (a thesis which might prove unattractive to customers of Yorkshire Water!) Professor Kay advocates the introduction of a "customer corporation" whose dividends would be related to lower levels of customer service charges, perhaps a surprising initiative given the generally conservative tenor of his book. For further theoretical discussion of the role of shareholders in privatised enterprises see Saunders and Harris, supra note 21, chapter 7.
eventual form of government policy. Similar work has been carried out in Britain. This is not to say that interest groups constitute the only effective form of political participation. Indeed, individual involvement in civic affairs by public spirited citizens is a long standing aspect of the US republican tradition. However it is unnecessary for the purposes of the present chapter to embark on a detailed analysis of different theories of liberalism and republicanism and their respective visions of society.

One significant initiative in this area should however be mentioned. This is the work of Nonet and Selznick in developing their concept of responsive law. These authors viewed the process of legal evolution in modern democracies as consisting of a

28. Becker, "A Theory of Competition among Pressure Groups for Political Influence" (1983) 98 Qty Jnl Econ 371 at 396: "Policies that raise efficiency are likely to win out in the competition for influence because they produce gains rather than deadweight costs, so that groups benefited have the intrinsic advantage compared to groups harmed. Consequently, this analysis unifies the view that governments correct market failures with the view that they favor the politically powerful by showing that both are produced by competition among pressure groups for political favors." In similar vein see Becker, "Competition and Democracy" (1958) 1 Jnl L & Econ 105; Downs, An Economic Theory of Democracy (Harper & Row, New York, 1957); Buchanan and Tullock, The Calculus of Consent (Univ of Michigan Press, Ann Arbor, 1962); Niskanen, Bureaucracy and Representative Government (Aldine, Chicago, 1971); McCubbins, Noll and Weingast, "Administrative Procedures as Instruments of Political Control" (1987) 3 Jnl L Econ & Org 243.


transition from an earlier era of repressive law, based on coercion, on traditional
document with a strong moralist element, and on punitive sanctions, through to an era of
autonomous law in which institutions and the bureaucracy would assert their authority.

In their view autonomous law would be characterised by rule-bound structures and an
emphasis on procedural regularity. In the ideal state of development autonomous law
would in turn give way to responsive law. This would emphasise the central role of
participation and both individual and group initiative in the structuring of what Nonet
and Selznick termed 'postbureaucratic organizations'. Their view of a responsive
legal order was closely related to more flexible and adaptive forms of regulation, both
economic and social, a function which was wider than the activities traditionally carried
on by the US regulatory agencies and which would serve to integrate regulatory action
in the public interest with notions of democratic participation and involvement.

The views advanced by Nonet and Selznick depend heavily for their realisation on the
design of new forms and structures in the public law area as the authors themselves
recognised and emphasised. Nevertheless, the ideas of these two writers are clearly

33. Ibid pp 99-100: "The special problem of postbureaucratic organization is to enlist participation,
to encourage initiative and responsibility, to create what Barnard called 'cooperative systems'
capable of tapping the autonomous 'contributions' of multiple constituents. In purposive
organization authority must be open and participatory: consultation is encouraged; reasons for
decisions are explained; criticism is welcome; consent is taken as a test of rationality. The
hallmarks of postbureaucratic organization are the following....Participatory decision making as
a source of knowledge, a vehicle of communication, and a foundation for consent. These
principles and forms are the 'leaven in the democratic dough'."

34. Ibid pp 108-109: "If there is a paradigmatic function of responsive law, it is regulation, not
adjudication. Broadly understood, regulation is the process of elaborating and correcting the
policies required for the realization of a legal purpose. Regulation thus conceived is a
mechanism for clarifying the public interest. It involves testing alternative strategies for the
implementation of mandates and reconstructing those mandates in the light of what is learned.
This function cannot be identified with the work of 'regulatory agencies' as we know them. Rule
making and enforcement may be involved in the regulatory function but they do not define it -
that is, unless they are understood in the far larger sense of policy making and administration.
Making 'rules', sensu stricto, is only one way among many of elaborating policy, for example,
establishing 'performance criteria', defining 'operational goals', formulating 'guidelines'. And
prescribing is only one of many ways of getting things done, for example, allocating resources,
creating incentives, establishing facilities, providing services."

35. Ibid p 111: "Administrative law as we know it, is better understood as an heir of autonomous
law than as a harbinger of responsive law. It remains a law of the judicial review of
administrative actions, a law of the procedural rights of parties affected by administrative
decisions, a law of the grounds for invalidating administrative policies and restraining
administrative powers. Responsive law aims at enablement and facilitation; restrictive
accountability is a secondary function. A new kind of lawyerly expertise is envisioned -
expertise in the articulation of principles of institutional design and institutional diagnosis. Such
relevant to questions of regulatory policy and analysis. Later writers in the area of regulatory design, such as Ayres and Braithwaite, have applied the attributes of the concept of 'responsive law' to their own conception of 'responsive regulation', while not necessarily accepting the validity of the transition from repressive to autonomous through to responsive law envisaged by Nonet and Selznick. In their book on the subject Ayres and Braithwaite placed emphasis on the need to develop effective regulatory policies which surmount traditional pitfalls such as regulatory capture, conflicting internal policies and self-defeating regulatory strategies. More recently Hutton has also pointed to the need to consider such an approach in Britain.

The above emphasis on putting in place regulatory procedures which respond to the needs of particular regulatory situations and which recognise the desirability of encouraging participation in the regulatory process, is to be welcomed. However, before turning to consider how such mechanisms might be implemented in practice, some further consideration needs to be given to the issue of how the concept of the 'public interest' can be defined in the regulatory context.

principles would analyze the characteristic institutional problems that are associated with carrying out different kinds of mandates and exercising different kinds of powers in different kinds of environments, and would point to the institutional mechanisms by which such problems may be corrected or moderated."

36. See Ayres and Braithwaite, *Responsive Regulation. Transcending the Deregulation Debate* (OUP, New York and Oxford, 1992), p 5: "Although our ideas for responsive regulation bear many of the marks of Nonet and Selznick's (1978) 'responsive law' concept - flexibility, a purposive focus on competence, participatory citizenship, negotiation - we are skeptical about repressive, autonomous and responsive law being evolutionary stages in legal development. Indeed Nonet and Selznick...themselves are careful to limit their claims that responsive law is a developmental response to the stresses inherent in the functioning of autonomous law. Our attempt to sensitize readers to innovative regulatory possibilities thrown up by thinking responsively is devoid of any grand theoretical aspirations."

37. Hutton, *The State We're In* (Jonathan Cape, London, 1995), p 292: "The 'republican' regulator celebrated by Ian Ayres and John Braithwaite - flexible, negotiating, focusing on competence, imbued with a sense of wider interests, conscious that citizens have a right to participate in decisions - is conspicuous by its absence. Something similar could be said for all British attempts at regulation. In the law, the media, the police, financial services, even sport they are characterised by the same mix of self-regulation, with a spatchcock system of regulation bolted on here and there, usually as a result of some historic failure that required drastic action. But statutory regulation, when imposed from above, is not republican in spirit. It amounts to direct governance by the state, with no redress; and the state is still the party that commands a majority in the House of Commons."
5.3.2 The Meaning of the 'Public'

In developing an improved model of regulatory intervention in economic matters it is necessary to consider what is meant by the 'public interest' in this context. It will be recalled from the discussion in chapter 2 that theories as to the legal nature of the public utilities themselves evolved from the common law concept of a business which provided an essential service and which was consequently affected with a public interest. This notion was given tangible recognition by the common law courts in both England and America by reference to the twin features of service and price. The operators of such businesses were required to provide a universal service without discrimination and at a reasonable price. It is interesting to reflect on the fact that these original attributes, which clearly favoured the interests of customers over those of the owners and operators of the businesses themselves, seem to have subsequently become diluted over time.

In the United States, government regulation by federal and state regulatory commissions reaches back to the late 19th century and the early years of the present century, as will be discussed in chapter 6. The earlier US cases recognised that there was a direct relationship between the need for regulation of certain kinds of business and the public interest as the US Supreme Court noted in a 1922 decision.38

The US Supreme Court eventually came to identify three classes of business which it considered were "affected by a public interest". These were, first, businesses carried on under a public grant of privilege, such as public utilities, common carriers and railroads, secondly, certain exceptional occupations such as inn keepers, cab operators and mills for the grinding of wheat and, thirdly, businesses which had subsequently become subject to government regulation by virtue of their intrinsic economic

38. Charles Wolff Packing Company v Court of Industrial Relations of the State of Kansas 262 US 522 at 536 (1922): "In a sense, the public is concerned about all lawful business because it contributes to the prosperity and well-being of the people. The public may suffer from high prices or strikes in many trades, but the expression 'clothed with a public interest' as applied to a business, means more than that the public welfare is affected by continuity or by the price at which a commodity is sold or a service rendered. The circumstances which clothe a particular kind of business with a public interest, in the sense of Munn v Illinois (1877) 94 US 113, and the other cases, must be such as to create a peculiarly close relation between the public and those engaged in it, and raise implications of an affirmative obligation on their part to be reasonable in dealing with the public."
significance. Until quite recently therefore, the concept of the public interest in regulatory matters, especially so far as the public utilities were concerned, focused on the right to obtain service at a price which did not unfairly exploit the captive recipient. Similar sentiments can be found in more recent US cases on competition and regulatory policy.

Apart from these fairly general conceptions, the earlier literature on public interest conceptions of regulation tended not to develop the concept of the public interest any more explicitly. The American political scientist John Dewey, writing in 1927, recognised that human acts could have both direct and indirect effects. In his view, the extent to which a particular action affected those beyond the persons directly involved determined the extent of its public character.

From this foundation, Dewey went on to link the concept of the public to the need for state intervention to protect its members from the consequences of the actions of others. In Dewey's view, an assessment of the essential goodness of any particular state was the extent to which its institutions performed their function of safeguarding

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40. See for example the observations of Judge (now Justice) Breyer in *Interface Group Inc v Massachusetts Port Authority* 816 F 2d 9, 10 (1st Cir. 1987) that the primary goal of competition and regulatory policy was to "bring consumers the benefit of lower prices, better products and more efficient production methods."


42. *Ibid* pp 12-13: "When the consequences of an action are confined, or are thought to be confined, mainly to the persons directly engaged in it, the transaction is a private one. When A and B carry on a conversation together the action is a transaction: both are concerned in it; its results pass, as it were, across from one to the other...it is private. Yet if it is found that the consequences of conversation extend beyond the two directly concerned, that they affect the welfare of many others, the act acquires a public capacity, whether the conversation be carried on by a king and his prime minister or by Cataline and a fellow conspirator or by merchants planning to monopolize a market."

43. *Ibid* pp 15-16: "The public consists of all those who are affected by the indirect consequences of transactions to such an extent that it is deemed necessary to have those consequences systematically cared for. Officials are those who look out for and take care of the interests thus affected. Since those who are indirectly affected are not direct participants in the transactions in question, it is necessary that certain persons be set apart to represent them, and to see to it that their interests are conserved and protected."
public interests. Later writers refined Dewey's concept of the interests of the public by considering the relationship between 'the public' and 'a public', as a subset of the general category. This led logically to an exploration of the connection between the concept of segments of the public and interest groups, a concept that was explored by Truman and others.  

A good deal of more recent academic thought, particularly in the United States, has been devoted to classifying the public interest in terms of the role of government officials in translating political norms into government action. However these theories are of limited explanatory power in the present context so far as an analysis of what constitutes the public interest is concerned. Economic theoreticians have tended to focus on the influence of market factors in approaching this issue. Posner, for example, viewed public interest theories of regulation as being predicated on the notion that "regulation is supplied in response to the demand of the public for the correction of inefficient or inequitable market practices." He doubted the validity of this theory in the US context and promoted the alternative concept of regulatory capture, under which regulation was said to be put in place to advance the overriding interests of the regulated industry. The attributes and validity of capture theory in both the United States and Britain will be discussed further in chapters 6 and 7.

In his comprehensive survey of the evolution of public interest theories of regulation in the United States, Mitnick, writing in 1980, noted that the formative regulatory agencies such as the ICC, the Federal Reserve Board and the Federal Radio Commission, were created under legislation which spelt out only vaguely a coherent

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44. Truman, The Governmental Process: Political Interests and Public Opinion (Greenwood Press, Westport, Connecticut, 1981, first published 1951), at p 218: "It will be apparent that there is a connection between this conception of a public and that of an interest group. Broadly viewed, an interest group is a segment of a public that shares a similar view of, or attitude toward, the consequences under discussion. It may be merely a potential interest group, of course, or an actual one if its members attempt to 'do something' about the consequences."


conception of the public interest. Mitnick observed that it was possible to discern what he termed a group public interest approach, which was motivated by relationships between interest groups and the particular regulatory body, where some groups (which he termed "control groups") had an advantage over weaker groups in the determination of regulatory policy. He also noted the evolution of functional public interest theories based on a consideration of economic arguments, as pioneered by Posner and others. Much of this work, written prior to the current period of privatisation and deregulation in the US and elsewhere, did not perceive the need to develop a model of public interest regulation which would balance the interests of conflicting participants in the regulatory process, a task which now confronts us.

Some writers in this area have advanced a broadly-based vision of the public interest, which imposes quite demanding obligations on administrative agencies. The US political scientist Herbert Simon, for example, considered that fulfilling the criterion of administrative efficiency obliged an agency to weigh up and consider a wide range of community values.

Such an approach runs the risk of becoming tautologous. The administrator must give effect to all relevant community values that are reasonably ascertainable. And who is ascertain these values? The administrator! Other commentators such as Noll, recognising the essential vagueness of the concept of the public interest, have emphasised the key policy-making role of administrators and regulators acting in good faith. From a behavioural perspective the public interest is what they strive to

50. Simon, *Administrative Behaviour* (The Free Press, New York, 1976, first published 1945), p 186: "...in actuality, administrators in reaching decisions commonly disclaim responsibility for the indirect results of administrative activities. To this point of view we oppose the contrary opinion that the administrator, serving a public agency in a democratic state, must give a proper weight to all community values that are relevant to his activity, and that are reasonably ascertainable in relation thereto, and cannot restrict himself to values that happen to be his particular responsibility. Only under these conditions can a criterion of efficiency be validly postulated as a determinant of action."
achieve even if they are not certain where its boundaries lie. Such a view, while admirably pragmatic, may also run the risk of elevating agency action to a level of virtue or competence which it may not necessarily possess. From a legal, as opposed to a political science, perspective it seems desirable to attempt to offer some meaningful guidance to regulatory bodies charged with implementing economic regulation in the public interest.

In approaching this task, it is clear that adequate mechanisms need to be devised to ensure that the perspectives of various interests or stakeholders are adequately represented in the determination of regulatory decisions. However, such mechanisms must also meet the criteria imposed by the various regulatory benchmarks set out in chapter 1. The following part of the chapter details a possible approach.

5.4 Regulation in the Public Interest - An Improved Model

5.4.1 Areas of Conflict in the Regulatory Process

In developing an improved model of regulation in the public interest, some consideration needs to be given to the legitimate aims and objectives of different participants, or stakeholder interests, as these have been outlined above. It can be seen from that discussion that there are several basic dichotomies. Probably the most basic of these is the conflict between achieving a maximum rate of return combined with regulation of the minimum level of intrusiveness (an objective likely to be sought by shareholders, regulated firms and their management) and providing services at a price which is reasonable and which does not exploit a position of natural monopoly or

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foundation for a 'public interest' as a clear, identifiable concept does not imply any fundamental error in public-interest theories of regulatory behaviour. As long as officials believe that a public interest has been defined for them and act to serve it, the fact that the public interest they perceive lacks interesting normative properties is unessential to the theory of their behaviour. The key issue is what they perceive the public interest to be, not whether their beliefs are correct or theoretically well founded." See also Joskow and Noll, "Regulation in Theory and Practice: An Overview" in Fromm (ed), Studies in Public Regulation (MIT Press, Cambridge, Mass, 1982), pp 50-51: "For all intents and purposes, the organization's perceptions constitute the reality in which it operates. The structure of the environment that the organization perceives may be quite different from the objective reality; however, this structure or model of the economic or political environment works from the viewpoint of the organization, in that it consistently explains the behaviour with which the organization is concerned."
market dominance (an objective likely to be sought by consumers). At the same time
disruption arising from market failures or a transition to a more competitive market
structure must be minimised (an objective which is likely to be sought by employees
and suppliers of equipment and services). Finally, the government has the probably
unenviable task of reconciling these differing objectives in the context of its overall
planning and policy role at the political level.

There are accordingly several areas in which direct conflict is likely to arise in the
process of economic regulation. The first, and perhaps the most obvious, is in relation
to the setting of prices or rates of return in relation to utilities or other businesses with
natural monopoly attributes. Secondly, there may be problems of co-ordination and
efficiency even in a competitive market, as the discussion in previous chapters of the
UK local bus transport industry and the structure of privatised rail transport have
shown. Thirdly, the regulatory process may have to allocate licences or franchises
among competing applicants, as in the case of the licensing activities of the CAA and
ITC.

Further, there may be difficulties encountered by competitors and intending competitors
in gaining adequate access to an existing transmission or distribution network, or in
other words problems of interconnection. Various other regulatory problems may arise,
such as the extent to which a regulatory regime should reflect third party interests such
as environmental protection and the extent to which various groups should participate
in the setting of regulatory policy, but the foregoing categories are likely to represent
the principal sources of regulatory conflict.

5.4.2 The US Approach

In formulating an improved regulatory model based on public interest considerations it
is useful to consider the US experience with economic regulation. In US regulatory
practice, the approach to regulatory decision making has been dictated both by
constitutional requirements of due process and by the standardised procedures
contained in the US Administrative Procedure Act. Two basic techniques, rulemaking
and adjudication, have been developed as the principal tools of economic regulation in
the US. These techniques will be analysed in more detail in chapter 6 but the present
discussion requires that a brief outline of them be set out here.

Rulemaking can be both formal and informal, though the latter kind is now much more
common. Informal rulemaking follows a 'notice and comment' procedure, under which
proposed rules are first formulated in draft by the agency concerned and are then
published for comment. Submissions are received from interested parties, these are
considered and appropriate amendments are made. Eventually the rules are finalised
and adopted by the agency. There is then the possibility (if not the likelihood) of
judicial review proceedings under which aggrieved parties can challenge the adoption
of the rules, often on the basis that they exceed the agency's statutory mandate or that
the agency record of the rulemaking procedure does not support the regulatory decision
in question.

Adjudication processes are becoming comparatively less significant in US regulation,
as the case studies in chapter 10 will illustrate. However, they remain of importance in
relation to utility rate setting procedures and in other contexts such as licensing
procedures. The adjudication process involves formal trial-type hearings before a
specially appointed hearing officer known as an Administrative Law Judge. Hearings
are preceded by extensive interlocutory procedures, including the use of pleadings and
discovery, and are accompanied by cross-examination and other adversarial trial
techniques. Liberal rules of standing apply and witnesses can be subpoenaed to attend
and give evidence. Frequently private individuals represent themselves at hearings,
especially in utility rate setting matters and in practice reasonable latitude is generally
extended to intending participants.

The US system is directed to achieving openness and transparency, while allowing all
legitimate participants the opportunity of reasonable participation. In relation to pricing
issues, firms such as utility companies must be able to justify their position to the
tribunal and to representatives of the consumer interest, who are frequently specialist
consumer advocates funded by the state government or by consumer organisations to
attend the hearings. Many regulatory decisions are taken by state public utility
commissions, consisting of up to five members, which reach decisions on various
matters of regulatory policy by consensus after considering the evidence and submissions advanced to them at regulatory hearings.

There may be other, less desirable aspects of the US system, such as cost, complexity and delay, although these can readily be (and have been) overstated by critics, as the discussion in subsequent chapters will seek to show. However, the great strengths of the American system are that it encourages meaningful participation in the regulatory process and provides effective and standardised structures to ensure that this goal is achieved.

5.4.3 The UK Approach

By way of contrast, the existing system of economic regulation in Britain has a number of discernible shortcomings. To begin with, it has tended to be essentially a closed system which has relied heavily on individual regulatory discretion. Although bodies such as the utility regulators have admittedly become increasingly responsive in recent years to the need for consultation and transparency, the system still falls far short of the US approach. While individual economic regulators in Britain have recently generally accepted the need to issue reasoned decisions, it is doubtful whether these will comment in detail on individual submissions by participating parties in the process. The process by which pricing decisions are reached, in particular, has remained something of a 'black box'. Experience suggests that in the past regulators have tended to err in exercising their individual discretion on pricing issues in favour of the regulated firms rather than the consumers, though there are recent indications that this situation may be changing.52

The UK system also suffers from a general inability to test regulatory data by adversarial procedures, including discovery and cross examination. While individual regulators have extensive powers to compel disclosure of regulatory information,

52. See the discussion of regulatory performance in these areas in part 7.4.6 of chapter 7. Recent pricing regimes introduced by OFTEL and OFGAS in mid-1996 have tended to be more stringent than in the past. One can only speculate on the extent to which the possibility of a change of government at the 1997 general election (as subsequently transpired) may have contributed to this approach.
mechanisms for assessing the accuracy and completeness of what is provided are less well developed. Similarly, avenues of judicial review under which the final decisions can be subjected to judicial scrutiny are much narrower in scope in Britain. There is also no official information legislation in force of the kind which exists in the United States and in many Commonwealth jurisdictions.

In addition, structures under which the consumer interest can be adequately represented are noticeably lacking. Much consumer input is derived from bodies which operate under the auspices of the regulator itself, as will be discussed in chapter 11. There are no independent bodies funded by the state which can participate directly in the process of regulatory decision-making through trained and specialised advocates, as in the United States. The actual regulatory decisions themselves are taken by single individuals, at least nominally in any event, leading to personality clashes and sometimes considerable antagonism between particular regulators and the management of regulated firms, as experience in recent years with the regulation of the privatised utilities illustrates.53

5.4.4 Outline of an Improved Model of Regulatory Intervention

This part of the chapter outlines an improved model of regulatory intervention which endeavours to take account of public interest considerations. The first prerequisite of this model is that the government itself should adopt greater responsibility for the framework in which economic regulation operates. This requires a clear legislative mandate setting out the objectives of regulation and the weight to be accorded to those

53. This can often descend to a comparatively petty, if not vitriolic, level. After his revised electricity pricing review was issued in March 1995 the electricity regulator, Professor Littlechild was variously described in the financial press as a 'bearded academic', a person who operated in an 'ivory tower' and who was 'out of touch with the real world.' (See the discussion in part 7.4.6(i) of chapter 7.) Following his stance in late 1995 on the need for stronger regulatory powers to counter anti-competitive behaviour by BT the Director General of Telecommunications, John Cruickshank, was accused by BT management of being 'out to destroy' the company. After the gas regulator Ms Spottiswoode, announced a more stringent gas pricing regime in May 1996 the chairman of British Gas, Mr Richard Giordano, cancelled a planned lunch with her in a fit of pique. (See article by Hosking in the Independent on Sunday, 19 May 1996, "British Gas 'in battle mode'", in which it was noted: "Ms Spottiswoode revealed that Dick Giordano, the British Gas chairman, had cancelled a lunch appointment with her on the grounds that he might end up shouting at her.")
goals. Regulators should operate under the context of broad guidance agreed with the relevant government departments, such as the Department of Trade and Industry. In this area, an adequate competition law framework is also important. While the prospects of significant legislative reform in this area in the UK appeared to be limited (at least until quite recently), in an ideal situation competition law should comprehensively address the use of anti-competitive practices in the market and provide adequate penalties to deter their occurrence.

The preservation of a competitive market also requires a more coherent policy in the area of mergers and takeovers. In particular clearer rules need to be introduced dealing with matters such as vertical integration on an industry basis and cross-utility ownership. The regulators themselves need to be given sufficiently flexible powers to address issues such as abuse of dominant position or market power, perhaps along the lines of the current OFTEL initiative, which is one of the case studies discussed in chapter 9.

At the level of individual regulatory decisions, mechanisms to promote genuine participation need to be introduced. As set out above, rights of participation are of limited use unless there is a structured framework within which they can be exercised. In the case of consumers and other third parties, steps need to be taken to create independent, adequately funded methods of participation, perhaps by instituting a system of consumer advocates who can play an active part in regulatory decision making processes. There are issues which will be addressed further in chapter 11.

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54. For one perspective on this issue see an article by John Redwood in *The Times*, 1 June 1996 at p 20: "Presiding Over Utility Monopoly - After a Week of Merger Mania, John Redwood Tells the DTI to Stop Privatised Industries Becoming a Corporate Adventure Playground": "No [regional electricity] company should be allowed to buy and own more than one distributor. No company should be able to buy or own two existing generators. A policy statement such as this would save a lot of time and trouble in the industry. Businesses that own power plant and wish to expand in power generation would then know that they had to grow by new building not by acquisition. Every one would know the score on owning regional monopolies. Next the Government should explain its position on cross-utility ownership. Is it acceptable for a company to own a regional distribution monopoly in both gas and electricity? The would-be monopolists tell us that this would increase efficiency and cut prices... Should this be allowed, with the regulator insisting on the price advantages that are promised? Or is the public right to be sceptical of so much power concentrated in so few hands? I am rather suspicious myself. I think it would be better if the gas and electricity industries explored meter-reading and billing solutions without buying one another up."
In relation to pricing and servicing issues, where testing the accuracy of regulatory
information is crucial, the adoption of some form of inquisitorial or adversarial
procedure would seem to be inevitable. There have been too many cases in recent UK
practice where pricing reviews have given rise to results which have subsequently been
found to favour unduly the interests of regulated firms. Examples of these can be found
in electricity, water and telecommunications and these will be discussed further in
chapter 7. Even where this may not be the situation, and where a regulated firm
complains that a pricing regime is too onerous, the absence of such procedures,
combined with the existence of a virtually unfettered regulatory discretion, mean that
there is no independent means of ascertaining the true position. Anyone interested in
the outcome of the process must largely accept the assertions either of the regulator or
of the regulatee concerning the degree of stringency of the pricing regime imposed
unless they are able and willing to carry out their own analysis from whatever
information is publicly available. It is interesting to note that the Labour Party, when in
Opposition, supported the introduction of a system of "public hearings on prices,
service standards and profits before price decisions are made."^5

This need not mean that contested regulatory hearings should always run the full
distance or that negotiated settlements or ADR type techniques are inappropriate, as
subsequent chapters will demonstrate. After pre-hearing procedures such as discovery
and exchange of witness statements and expert's reports have been completed there will
often be an adequate information base on which a resolution of the issues can occur, as
contemporary US experience in this area illustrates. If a consensual solution cannot be
reached at this point it should be possible to invoke streamlined arbitration or dispute
resolution procedures to ensure that matters are resolved expeditiously. The Australian
and New Zealand experience with introducing such procedures, as discussed earlier, is
of relevance here.

The significant factor is that the structure should provide adequate information to
participants and should not exclude parties with a legitimate interest in the outcome
from involvement in regulatory determinations. Exclusion is not only a matter of
procedure - it also involves issues of funding and access to suitable expertise. These

55. See editorial in the Financial Times, 2 May 1995: "Labour's love of the market."
are not merely legal issues but involve financial, economic and technical ones as well. This is of particular importance in a jurisdiction such as the United Kingdom which has no official information legislation in force and where public administration and the civil service have traditionally operated in an atmosphere of comparative secrecy. The best way of eliminating the possibility of capture or the influence of special pleading on the process of economic regulation is to ensure as far as possible that all interested stakeholder groups have equal opportunity to carry out the capturing or the pleading.

Issues of interconnection in the UK are similarly vexed. Taking the example of telecommunications, while the interconnection arrangements for the original duopoly situation involving BT and Mercury worked reasonably well,\(^56\) there are indications that as the market has opened up to greater competition from a larger number of intending entrants, BT has adopted less tangible but nevertheless effective techniques to frustrate or delay effective interconnection by competitors.\(^57\) Such issues are probably best addressed by an adequate competition law framework and by conferring sufficiently flexible powers on a regulator to take appropriate action as necessary. The same can be said for market failures which occur in ostensibly competitive markets, such as aggressive, cut-throat competition in the UK local bus industry, which is at present largely unregulated. As the current Chairman of the Office of Fair Trading, John Bridgeman, has recently noted, regulators have a legitimate role in ensuring that competition functions effectively.\(^58\)

It is apparent from the above discussion that this writer favours certain limitations on the present concept of independent economic regulation so as to oblige regulators to take account of government industrial policy on a sectoral basis, as conveyed through

\(^56\) See the discussion in part 4.6.4 of chapter 4.

\(^57\) See the discussion in parts 9.6 to 9.7 of chapter 9.

\(^58\) John Bridgeman, article in The Times, 25 May 1996, p 24: "Why Open Competition is Better than Regulation": "Unfortunately, large dominant firms are too often inefficient, lethargic and tempted to behave anti-competitively rather than win market share by virtue of superior efficiency and effectiveness. Everyone involved in the 'contract' is then a loser; the company maintains its inefficiency, potential rivals find the market place is closed to them and the consumer is robbed of choice and the chance to secure best value for money. Sometimes regulators have to step in to ensure that competition does work effectively. But competition is not always sufficient. Consumers need to be adequately protected not only against the abuse of market power for monopoly, but also against unfair or misleading selling techniques. Consumer protection and competition policy are integrally linked."
suitable guidance statements. In response to the possible objection that this would undesirably compromise the concept of independent regulation, as it has been pursued in both Britain and the United States, one can argue that regulatory independence is often not as strong as it appears to be. In the United States, for example, the regulatory commissions are in fact considerably constrained in practice by the need to secure continued Congressional funding and support and by the cost/benefit requirements imposed by the Executive. Regulatory decisions are also limited by public scrutiny and by wide powers of judicial review, which relate the content of such decisions to the statutory mandate given to the agencies and to the procedures followed for the adoption of regulatory rules. These matters will be canvassed further in the following chapter.

In Britain, there are examples of economic regulators such as the Civil Aviation Authority which are not completely independent of government in the sense that the Secretary of State for Transport has important residual powers under their empowering legislation. However, as will be discussed in chapters 6 and 8, such a structure does not appear to have adversely affected CAA decision making, particularly in the area of route licensing, to any undue extent. Similar arguments apply in the rail context in the case of the Director of Passenger Rail Franchising, where the central importance of the franchising process to the privatised rail network was recognised, at least at the level of theory, by putting formal accountability structures in place in relation to the activities of OPRAF.

In any event, why should independent regulation necessarily be synonymous with an almost complete lack of accountability to Parliament or the relevant Minister on the part of regulatory bodies? Where, as in Britain, regulatory bodies do not operate within the framework of a written constitution or under the limitations of a defined separation of powers and functions, and the supervisory remedy of judicial review is more limited in scope, it is all the more important to ensure that powerful regulators cannot act entirely independently of government policy or guidance.59

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59. As Simon Jenkins concluded in his entertaining recent book, *Accountable to None* (Penguin Books, London, 1996) at pp 39-40: "There was no formal accountability to parliament via ministers, only informally through appearances at select committee hearings. Ministers controlled regulators' terms of reference and were free to pass laws changing them. Yet ministers denied any further responsibility. They had declared the regulators 'non-ministerial', independent, agents of the state yet responsible to it only in some metaphysical
How this might be implemented in practice is more problematic, though clear published guidelines setting out the results to be achieved from the regulatory framework and the use of more formal accountability structures, would not seem to be an excessively burdensome method. To those who contend that such an approach would unduly impinge on the rights of shareholders in privatised enterprises, a simple response is that their rights should not be allowed to prevail over the legitimate government interest in the setting of economic and regulatory policy. This is an interest which should be wider than simply preserving the interests of shareholders as a stakeholder group, as has too often tended to be the case in recent UK experience.

An improved model of regulatory intervention would address imbalances of power in the process of reaching regulatory decisions by the use of structured mechanisms which facilitate participation. These issues are difficult to grapple with, but unless there is a willingness to confront and resolve them, the UK process of economic regulation may simply continue to be characterised by shareholder smugness, corporate greed and widespread consumer dissatisfaction. While sentiments of these kinds may no longer be the stuff of revolution and revolt, as they might have been in a former era, there is no reason in these apparently more enlightened times not to address their root causes. In the end structural failings of this nature go directly to the heart of the nation's economic competitiveness and well-being. They involve moral arguments and not solely economic ones, as Will Hutton has aptly said. But how can such an approach be implemented? This is an issue which will now be addressed.

sense. Of all the institutions of Thatcherism, the utilities regulators were the least coherent or democratic."

60. Hutton, supra note 37, p 24: "For what binds together the disorders of the British system is a fundamental amorality. It is amoral to run a society founded on the exclusion of so many people from decent living standards and opportunities; it is amoral to run an economy in which the only admissible objective is the maximisation of shareholder value; it is amoral to run a political system is which power is held exclusively and exercised in such a discretionary, authoritarian fashion. These exclusions, while beneficial in the short-term to those inside the circle of privilege, are in the long run inefficient and ultimately undermine the wealth-generating process."
6. REGULATORY TECHNIQUES IN THE UNITED STATES

6.1 Introduction

6.1.1 A Brief Background

The purpose of this chapter is to discuss some aspects of the United States regulatory scene in order to see what lessons this may provide for economic regulation in the United Kingdom. Emphasis will be placed on explanatory theories of the regulatory agency, the theory and practice of rule making by the US regulatory agencies, the role of judicial review and on innovative approaches to contemporary regulatory issues.

At an early stage, the thrust of the United States approach to economic regulation diverged in its direction and emphasis from that taken in the United Kingdom. In the field of public utilities, for example, a period of initial municipal ownership led in the early part of this century to control through the use of state public utility commissions. This technique was progressively refined in the present century and regulation of utility rates still remains an important part of the American regulatory scene. In other areas of the US economy the use of independent regulatory commissions came to be the predominant method of regulation employed. The role of the Antitrust Division of the US Department of Justice is also important and will be described further below.

As might be expected, US experience with the use of government or publicly-owned corporations has been more limited than in the United Kingdom and Commonwealth jurisdictions. The influence of the privatisation movement has therefore not manifested itself in quite the same way in the United States as has been the case elsewhere. Nevertheless examples of government-owned corporations can be found in the United States and these will be discussed below.

Brief reference to the evolution of US regulatory institutions was made in part 1.6 of chapter 1 and a more expanded account of this process is contained in this chapter. The first national regulatory agency was established in the United States in 1887 in the form of the Interstate Commerce Commission. In the field of public utilities, state utility commissions were established in 1907 in New York and Wisconsin. These two bodies
served as the models for subsequent state regulatory commissions, which numbered more than thirty by 1920. Utility commissions are now to be found in all of the states.

The New Deal era of the 1930s witnessed the establishment of several federal regulatory commissions, including the Federal Power Commission, later the Federal Energy Regulatory Commission (responsible for the regulation of electricity generation and natural gas distribution systems), the Federal Communications Commission (responsible for regulating interstate telephone services) and the Securities and Exchange Commission (responsible for the regulation of financial services and the financial operations of entities such as electricity and gas utility holding companies).

Federal administrative agencies increased in importance in the post-war period especially following the passing of the Administrative Procedure Act in 1946. A Federal Aviation Authority was established in 1948, followed in the early 1970s by the Environmental Protection Agency (EPA) and the Occupational Safety and Health Administration (OSHA). The high water mark of regulatory intervention in the United States economy was undoubtedly the mid-1970s. By the end of that decade a backlash in favour of deregulation was beginning to take effect, a movement which gained impetus during the Reagan Administration in the 1980s.

These developments have been paralleled by legislative initiatives. Federal official information legislation came into force in 1967 and quickly came to be incorporated in the APA statutory procedures. The 1980s saw the introduction of cost/benefit requirements by way of Executive Order, followed by statutory provisions dealing with negotiated rulemaking (passed in 1990). More recently there have been moves (so far inconclusive) to amend the US APA so as formally to introduce concepts of cost benefit analysis and risk assessment into regulatory procedures.

1. For an early general discussion of the operation of the State utility commissions see Pond, A Treatise on the Law of Public Utilities (Bobbs-Merrill Co, Indianapolis, 1913).

2. The course of regulatory decision making in the United States over the past few decades is illustrated by the comparative size of the US Federal Register, in which copies of all proposed and adopted federal regulations are published. In 1960 the Register contained 14,479 pages. By 1980 it had increased to 87,012 pages. By 1986, when the movement towards deregulation was well advanced, the Register had reduced in size to 47,418 pages.
The rise of the administrative agency, inexorable though it may have been, has proved to be somewhat controversial in United States experience. Its opponents have cast doubt on the constitutional validity of the agencies and have deprecated the cost and complexity associated with regulatory adjudication and rule making procedures. Criticisms have also been advanced in relation to the alleged lack of independence of the agencies (often based on what is said to be their propensity to become identified with the interests of the regulated firms). On the other hand criticisms have also been made based on the excessive autonomy which the agencies are said to enjoy. These points of view will be analysed in more detail later in this chapter. Finally the involvement of the US administrative agencies in rule making activities has been and continues to be an important part of their operational activities. United States experience in this area is of importance to the development of this thesis and will also be examined in some detail below.

In summary therefore, this chapter chronicles the rise of economic regulation in the United States in the context of the applicable political, constitutional and administrative framework. It goes on to examine explanatory theories which have been advanced in relation to these agencies. The chapter then deals with some of the controversial aspects of their operations and finally examines the role of the agencies as administrative rule makers. The object of this exercise is to show what lessons can be learned from the United States experience in this area and to point out how United Kingdom regulation can avoid some of the difficulties which are considered to be inherent in the US system. One of the strengths of the US system of economic regulation is the way in which it achieves participation by affected parties in an atmosphere of full disclosure. The way in which this is accomplished will be considered further in some detail.

6.1.2 The Purpose of the US Regulatory Agencies

Before embarking on the discussion in this chapter it is worthwhile setting out briefly the aims and objectives of the US regulatory agencies in the economic sphere. As will shortly be seen, many of these agencies grew out of the need for government economic intervention which was perceived during the New Deal era of the 1930s. During the
1950s and 1960s other agencies came into being in different areas of the US economy and the powers and jurisdiction of the existing agencies were expanded. In part 1.9 of chapter 1, the main objectives of economic regulation were discussed, as developed in the United States context through the work of Breyer, Stewart and others. As that discussion showed, the US regulatory agencies were, at least in theory, directed towards redressing various economic imperfections, such as instances of market failure, problems arising from natural monopoly, externalities and unequal access to information.

An analysis of the work of the original "Big Six" US regulatory agencies in existence by the 1950s illustrates the problems they were designed to address. To begin with the earliest agency, the Interstate Commerce Commission (ICC), this was originally established to deal with the rapid expansion of the US railroad industry following the Civil War, a period which was accompanied by various abuses on the part of the "railroad barons" who often appeared to resemble more closely the robber barons of old rather than the representatives of a new and promising industrial age.

From these early origins, the ICC's powers gradually grew. Legislation in 1906 expressly conferred a general rate-making power on the ICC in relation to railroads, and also granted extended powers of enforcement. Under the Transportation Act 1920, the ICC was given the broader responsibility of ensuring the development of an adequate national rail transportation service. The additional jurisdiction granted at that time included authority over the issuing of railroad securities, extended powers over railway rates and power to approve consolidation of existing rail operations without the need for concurrent antitrust approval. The increased use of road transport also saw motor


5. See Schwartz, ibid, at p 25: "Freedom from public interference led to highly speculative railroad building, irresponsible financial manipulation, destructive competitive warfare resulting in monopolies, fluctuating and discriminating rates - and to the inevitable public reaction."
carriers placed under the ICC's jurisdiction in 1935, followed by domestic water transport in 1940. By the 1950s the ICC had general regulatory authority over all forms of interstate transport not involving aircraft.

The problem of controlling unfair competition was addressed through the establishment of a Federal Trade Commission (FTC) in 1914. The FTC was designed to provide a new administrative approach to antitrust issues. The Federal Trade Commission Act of that year addressed the problem in general terms by declaring unlawful "unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce." This general statutory jurisdiction was to be fleshed out by incremental decision-making on the part of the FTC, whose jurisdiction extended to industry as a whole, unlike that of the other regulatory authorities.6

Various criticisms have been made of the FTC's approach to its role. Consumer bodies have regarded its limited and selective enforcement policies with disfavour, whereas economists of the Chicago school and others have predicted (with varying degrees of accuracy) that the FTC Commissioners would be reluctant to undertake confrontational investigations involving powerful economic interests.7 Others have claimed that the FTC, far from being an independent regulator, was effectively a tool of Congress.8 The recent history of FTC regulation has illustrated the need for a coherent policy of antitrust enforcement in the public interest, an approach which has not always been evident with this particular regulator.9

6. For a general description of the powers and activities of the FTC see Schwartz, supra note 4, pp 29-32; Wilson, supra note 4, chapter 5.
The third of the Big Six agencies was the Federal Power Commission (FPC), later succeeded in 1978 by the Federal Energy Regulatory Commission (FERC). The activities of this agency arose out of attempts to develop a federal regulatory policy in respect of hydro-electric power resources. A Federal Water Power Commission was established in 1920 and this was succeeded by the FPC under the Federal Power Act 1930. The new commission again concentrated initially on hydro-electric power but its jurisdiction was progressively extended to all forms of interstate electricity generation. By the 1950s the FPC had a general supervisory jurisdiction over interstate electricity companies as well as in respect of gas companies. The FERC has recently claimed jurisdiction, under the Energy Policy Act 1992, in respect of "retail wheeling", the transmission of third-party generated electricity directly to retail customers by electric utility companies, although the demarcation between state and federal jurisdiction in this area remains controversial.

Regulation of the media industries, such as radio and later television, was the responsibility of the Federal Communications Commission (FCC) established under the federal Communications Act of 1934. The FCC initially assumed regulatory control over radio broadcasting, a task which had previously been the responsibility of the Federal Radio Commission, which had been established in 1927. The FCC was given a broad jurisdiction over all forms of broadcasting, including television services, and undertook substantial licensing activities. Its role has fluctuated considerably in recent years with the advent of the deregulatory era of the 1980s, the development of


11. See Chadwick, ibid, pp 211-212: "At minimum, Congress should clarify the jurisdiction issue. Whether it should devolve power to the states or retain it itself involves policy and political questions too complex to address here.... The present situation augurs years of wasteful regulatory uncertainty and needless litigation, probably culminating in a Supreme Court decision. FERC and state regulators could be faced with the task of 'unscrewing the eggs' of 30, 40, or more stymied state-level retail wheeling schemes." See also the discussion of this issue in part 10.2 of chapter 10.

12. The powers and legislative development of the FCC are set out in Schwartz, supra note 4, pp 35-39.
cable television services, and the recent passing of the Telecommunications Act 1996 by Congress and will be referred to further in the US case studies in chapter 10.

Regulation of financial services in the United States is carried on through the medium of the Securities and Exchange Commission (SEC), established under the Securities Exchange Act 1934 in response to the particular challenges posed by the New Deal era. Initially the SEC was principally concerned with ensuring that adequate publicity and information relating to issues of securities would be made available to investors, thereby reducing the risks of fraudulent promotions. This form of federal regulation followed the enactment at the state level of the so-called blue sky laws (based on the principle that sunlight is the best disinfectant) which began with a state law passed in Kansas in 1911 to control speculation in shares in mining and farming corporations.\(^{13}\)

The SEC's authority is based extensively on its powers to license issuers of securities and securities exchanges and includes powers to revoke or suspend licences already issued. The Commission enjoys wide discretionary authority in relation to these activities, and operates in close conjunction with various self-regulatory agencies such as the New York Stock Exchange. Its efficiency and usefulness have been the subject of some debate among economists and other academic commentators,\(^{14}\) but there is no doubting the considerable regulatory power which the Commission continues to exert in the financial services sector.

Finally, US air passenger transport has been the subject of extensive regulation, initially by the Civil Aeronautics Board (CAB), and more recently by the Federal Aviation Authority (FAA). The CAB was originally established in 1938 to regulate US civil aviation and for some 40 years it engaged in considerable licensing and rate making activity. The role of the board decreased considerably during the 1980s with the deregulation of domestic air transport in the United States. Since 1985 regulatory activity has tended to focus largely on safety issues and has been carried on by the

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14. See for example Stigler, The Citizen and the State - Essays on Regulation (University of Chicago Press, Chicago, 1975), who concluded at p 185 that the SEC "did not appreciably improve the experience of investors in new issues by its extensive review of prospectuses."
The regulatory activity of the CAB was formerly the subject of criticism on the grounds of inconsistency in decision making and the alleged susceptibility of the board to various political pressures. Under the new deregulated structure these matters are now largely of historical interest, although they do provide an interesting illustration of the effect of political influences on an ostensibly independent regulatory agency.

The activities of the principal US regulatory agencies in the economic area reveal some commonality of approach, but also some significant divergences. Some agencies, such as the FTC, have relied heavily on the development of regulatory policy through case by case adjudication of a quasi-judicial nature. Others, such as the FCC, the SEC and formerly the CAB, have tended to make extensive use of their licensing powers in regulatory matters. Rulemaking activity, while common to most of the agencies, has received greater emphasis at some (such as the ICC and FCC) than at others. While all of the agencies are ostensibly politically independent, the actuality of this situation also varies considerably in practice with some agencies enjoying (or labouring under) considerable Congressional and White House scrutiny and oversight. These aspects will be discussed in more detail below. The role of some of the agencies has diminished in an era of deregulation, as in the case of communications and civil aviation, whereas other agencies (such as the ICC and the SEC) have retained their powers and influence largely intact.

The role of public and administrative law is also of crucial significance in the US regulatory context. While the US agencies exercise considerable control over industrial and economic policy in their particular areas, their activities are subject in turn to close supervision and control by federal courts exercising the remedy of judicial review. The power to review agency action, expressly preserved in the US Administrative

15. For a general discussion of the activities of the CAB up to 1978 see Wilson, supra note 4, chapter 3; Caves, supra note 4, chapters 6-12.

16. See for example Caves, supra note 4, p 298: "The preceding chapters have begun from the unstated hypothesis that the Board's decisions in each substantive field make up a unified and consistent body of decisions based on definite principles. The hypothesis was only modestly confirmed. In certain areas, such as the route cases, one can conclude by arguing that the results could be the product of a single mind drawing upon a clear-cut preference map. In others, such as fare decisions, no significant consistency exists, and each decision seems very much the result of general conditions at the time it was reached rather than of the record before the Board."
Procedure Act, is more wide ranging than in the United Kingdom, as the discussion later in this chapter will illustrate. While in Britain judicial review of administrative action tends at present to be confined to reasonably clearly delineated spheres of intervention, the boundaries of the remedy in US law are less clear-cut as will be seen from the discussion in part 6.5.3 of this chapter.

As in the UK, some US courts have tended to extend considerable deference to agency decision making. However, others have taken a much more activist or interventionist approach. This has led, in effect, to the courts becoming an important arbiter of US regulatory affairs, through their role in upholding or overturning agency decisions. Some contend that intervention in this way by the third branch of government is constitutionally desirable, whereas others express a less sanguine view of the ability of federal judges to make de facto regulatory or industrial policy. Again, this debate will be canvassed more fully later in this chapter. Regardless of the merits or demerits of the US approach, the substantive effect is that US regulation tends to be essentially tripartite in nature as opposed to bilateral, as in Britain. This point can be conveniently illustrated in diagrammatic form as follows:

(a) The US Regulatory Position

Regulatory Agencies ———> Direct Control ———> Regulated Industries

Supervisory Jurisdiction

US Federal Courts

Indirect Control

(b) The UK Regulatory Position

Regulatory Bodies (limited susceptibility to judicial review) ———> Direct Control ———> Regulated Industries
At the state level, significant regulatory activity is exerted over public utilities, which are subject to the general jurisdiction of the state public utility commissions, a system dating back to the early years of the present century. This jurisdiction has centred on the rate making process and has involved the commissions in setting reasonable costs for furnishing utility services through trial-type proceedings. These powers have mirrored those of the federal regulatory commissions to regulate prices of products within their jurisdiction. The constitutionality of these powers at the federal level was conclusively confirmed in a leading Supreme Court decision given in 1944, earlier decisions of the Court having upheld the constitutionality of rate making procedures by state public utility commissions.

The public utility commissions function under the aegis of state legislation and exercise a significant role in the overall framework of US economic regulation. Their activities will be the subject of more detailed examination in the course of the US case studies in chapter 10. It should be noted, however, that there is some variation in US academic opinion in relation to the extent to which public interest considerations can justify a more stringent or aggressive approach in rate setting matters. In particular, views differ on the extent to which the fixing of a fair and reasonable rate in respect of public utility pricing can legitimately justify the imposition of extreme financial hardship on utilities,

17. See Federal Power Commission v Hope Natural Gas Company 320 US 591 (1944) per Justice Douglas at p 615: "No serious attempt has been made here to show that they [the factors taken into account by the Commission in its rate setting decision] are inadequate. We certainly cannot say that they are, unless we are to substitute our opinions for the expert judgement of the administrators to whom Congress entrusted the decision. Moreover, if in light of experience they turn out to be inadequate for development of new sources of supply, the doors of the Commission are open for increased allowances." See also p 617: "Congress has entrusted the administration of the Act to the Commission not to the courts. Apart from the requirements of judicial review it is not for us to advise the Commission how to discharge its functions."

18. See Smyth v Ames 169 US 467 (1898); Willcox v Consolidated Gas Co 212 US 19 (1909); Bluefield Waterworks and Improvement Co v The Public Service Commission of West Virginia 262 US 679 (1923). These decisions were conclusively affirmed by the Supreme Court in Market Street Railway Company v Railroad Commission of the State of California 324 US 548 (1945) at 568: "Under these circumstances we do not find that anything has been taken from the appellant by the impact of public regulation. If the expectations of the Commission as to traffic increase were well founded, it would earn under this rate on the salvage value of its property, which is the only value it is shown to have. If expectations of increased traffic were unfounded, it could probably not earn a return from any rate that could be devised. We are unable to find that the order in this case is in violation of constitutional prohibitions, however unfortunate the plight of the appellant."
perhaps even to the extent of bringing about their insolvency, without infringing Constitutional guarantees against confiscation of property.\(^{19}\)

Finally, in relation to the US regulatory agencies, the role of the Antitrust Division of the US Department of Justice (DOJ) should not be overlooked. This Division, which dates back to the time of the Sherman Act of 1890, represents one of the earliest US examples of federal control over anti-competitive business practices.\(^{20}\) The Division is unique as a regulatory tool in that it represents one of the few examples of a concerted US federal effort to use litigation in the courts as a means of economic regulation, in this case through enforcement of the antitrust statutes. The heyday of the Division is regarded by many as being during the 1970s and early 1980s. In more recent years a growing body of opinion has begun to argue that concerted enforcement of the antitrust laws in the Federal courts, sometimes through court action of epic proportions as in the case of the IBM and AT&T antitrust cases, has hindered rather than assisted economic progress in the United States. This is said to have resulted in difficulties of morale and a lack of strategic direction in the Division itself.\(^{21}\)

Nevertheless, the Division has played a significant role in many regulatory proceedings in recent years, particularly in the telecommunications industry where it was

\(^{19}\) See for example Drobak, "From Turnpike to Nuclear Power: The Constitutional Limits on Utility Rate Regulation" (1985) 65 BULR 65 (arguing at p 124 that existing doctrine justifies imposing "extreme financial harm" on utility companies in appropriate circumstances.) Cf Pond, "The Law Governing the Fixing of Public Utility Rates: A Response to Recent Judicial and Academic Misconceptions" (1989) 41 Admin LR 1, who takes the contrary view that the fixing of a fair and reasonable rate needs to take account of the legitimate business interests of the utility company in question to avoid infringing the Constitutional prohibitions against unlawful confiscation of property. For a discussion of the extent of the powers of the state public utility commissions see Fitzpatrick, "Toward a Broad Reading of Implied Powers of State Public Utility Commissions: Combating a Legacy of Laissez Faire" (1985) 90 Dickinson LR 415.


instrumental in helping to bring about the AT&T divestiture following protracted antitrust litigation from 1974 to 1982. In areas such as telecommunications, the sharing of regulatory jurisdiction among the Antitrust Division of the DOJ, the FCC and the State PUCs has been the subject of periodic Congressional criticism, but attempts to resolve the problem have so far met with limited success. The Division itself has no real counterpart as such in British regulatory practice, where bodies such as the Office of Fair Trading (OFT) tend to adopt a less proactive role under UK competition legislation, and where the competition laws are not structured so as to encourage direct resort to the litigation process on the part of government.

The debate over whether abuses of market power should best be addressed through the ordinary processes of litigation is a continuing one, both in the United States and elsewhere. In Commonwealth jurisdictions it is equally topical, as the discussion of the New Zealand experience in chapter 4 has shown. At the theoretical level, US commentators such as Breyer have pointed to some of the difficulties involved in applying general antitrust laws to particular industries using the litigation process. In his view, such an approach runs the risk that the particular needs of specific industries

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22. The AT&T judgments are reported in *US v AT&T* 552 F Supp 131 (1982) (Washington DC Dist Ct, 1982); affirmed in *Maryland v US* 460 US 472 (1983). The background to and effect of the litigation is described in Hills, *Deregulating Telecoms; Competition and Control in the United States, Japan and Britain* (Frances Pinter (Publishers), London, 1986), chapter 2; MacAvoy & Robinson, "Winning by Losing: The AT&T Settlement and Its Impact on Telecommunications" (1983) 1 Yale J on Reg 34 and in Chen, "The Legal Process and Political Economy of Telecommunications Reform" (1997) 97 Col LR 835 at 848 - 849. For a detailed, recent discussion of the work of the Antitrust Division and the use of the antitrust legislation in relation to the AT&T litigation see Scott, "Institutional Competition and Co-ordination in the Process of Telecommunications Liberalization" in McCahery, Bratton, Picciotto and Scott (eds), *International Regulatory Competition and Co-ordination* (Clarendon Press, Oxford, 1996). In an interesting recent twist, Judge Harold Greene, who presided over the AT&T litigation in the early 1980s, warned that AT&T's recent attempts to merge with SBC, the largest US regional phone company, would create the same kind of monolithic entity that the break-up was designed to eliminate. See article in *The Times*, 2 June 1997: "Judge warns over AT&T merger plan."

23. These jurisdictional issues are discussed in Johnson, "Redefining Diversity in Telecommunications: Uniform Regulatory Framework for Mass Communications" (1992) 26 U Calif Davis LR 87. The Telecommunications Act 1996 has tended to repatriate much of the regulatory power in this area to the FCC. See the discussion in part 10.7 of chapter 10.

24. See the discussion in parts 4.6.2 to 4.6.4 of chapter 4.
will be disregarded and that antitrust policy is likely to prove too blunt an instrument to deal with particular examples of anti-competitive conduct.25

The other difficulty with the US system centres around the control exercised by the Solicitor General over federal litigation in the US superior courts. Some US commentators have contended that such a system can defeat the concept of independent agency regulation, given that the Solicitor General retains overall control of federal litigation before the Supreme Court,26 and is therefore in a position to exert considerable influence over the ultimate shape of regulatory policy.

6.2 The Evolution of Economic Regulation in the United States

6.2.1 The Period up to 1929

Chapter 2 contained a discussion of the way in which American approaches to the treatment of public monopoly power in areas such as public utility services developed in a similar fashion to the experience in England, with judicial regulation in this area evolving during the 18th and 19th centuries. In that chapter the historical evolution of the concept of "business affected with a public interest" was examined in some detail, up to the important US case of Munn v Illinois,27 decided in 1876.

The Munn case was the first significant statement of principle by the United States Supreme Court dealing with that concept, following Sir Matthew Hale's formulation of the principle some two hundred years earlier.28 This period of judicial activism was


26. See the discussion in Devins, "Unitariness and Independence: Solicitor General Control over Independent Agency Litigation" (1994) 22 Calif LR 255.

27. 94 US 113 (1876). See the discussion in part 2.4.1 of chapter 2.

accompanied by corresponding legislative and administrative activity in the area of economic regulation. As noted above, the Interstate Commerce Commission (ICC) was established pursuant to the Interstate Commerce Act of 1887. The growth of railroads in the United States provided much of the impetus for this development, given the concern of the legislature at that time with preventing market abuses and the formation of cartels by the railroad companies.

This development was followed a short time later by the Sherman Act of 1890 which ushered in an era of federal legislative control in the antitrust area. The Sherman Act followed the passing of antitrust laws by several of the states, but it marked a new development in the federal legislative approach to the control of monopoly power. As Letwin has noted it was a more innovative measure than was evident at the time.

The passage of Senator Sherman's Act was accompanied by considerable acrimony and much resistance from the railroad companies and other business interests. Indeed its passage was opposed as bitterly as the old confederacy had opposed the Senator's older brother, General William Tecumseh Sherman. The general had gained fame (or notoriety) in 1864 during the Civil War when, in a fierce campaign which has remained controversial to this day, he had burned a path sixty miles wide through Georgia, from Atlanta to the sea.


30. See Letwin, ibid, at p 52: "But the Sherman Act went far beyond the common law when it authorised the Attorney General to indict violators of the Act, and gave injured persons the power to sue them, thus making it possible to enforce competition actively. The Act was therefore much more of an innovation than its authors realized. It did not, as they thought, merely declare the common law. It can almost be said to have helped to create the common law, in so far as its authors' convictions helped spread the belief that the common law always expressed as much antagonism to monopoly as they wrote into the Sherman Act."

31. Letwin tells us that Senator Sherman, who carried on a continuing correspondence with his older brother, saw the passage of the federal antitrust legislation, along with the tackling of the tariff question, as being the two most significant issues facing President Taft's administration. (See Letwin, supra note 29, p 58 and fn 2.)
Senator Sherman himself recognised the potentially harmful effects that abuse of market power could generate, as his Congressional speeches at the time of the passage of the Bill showed.32

At the philosophical level the proponents of the Sherman Act were responding to discontent, particularly among the farming sector, at price levels in general, the blame for which readily fell upon the large industry 'trusts', those monopolies and cartels which were thought to control essential sectors of the economy. The promotion of competitive goals had obvious political ramifications, as Heydon has noted.33 Heydon's reference (in the preceding footnote) to Justice Brandeis (as he later became) as one of the moving forces behind this process is well chosen. Brandeis, who introduced the type of brief which now bears his name where the court is given a broad picture of the social and economic implications underlying a particular dispute, was a lifelong opponent of the power of powerful vested interests where these conflicted with the rights of individuals.34

The stout resistance which the Sherman Act met with at the time of its passing was matched only by a corresponding lethargy of enforcement on the part of the authorities

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32. See the speeches quoted in Weaver, "Antitrust Division of the Department of Justice" in Wilson (ed), supra note 4, p 129, which include the following example: "If we will not endure a king as a political power we should not endure a king over the production, transportation and sale of any of the necessaries of life. If we would not submit to an emperor we should not submit to an autocrat of trade, with power to prevent competition and to fix the price of any commodity."

33. Heydon, "Restrictive Trade Practices and Unfair Competition" in Kamenka and Tay (eds), Law and Social Control (Edward Arnold, London, 1980), chapter 8, p 141: "At a more general level some of the legislators accepted a group of arguments, or visceral feelings, usually associated with the names of Jefferson and Woodrow Wilson, and, among judges, Brandeis and Douglas JJ. In Theodore Roosevelt's caricature, and to some extent in truth, these arguments amount to a 'sincere rural Toryism.' They turn on the merits of competition in avoiding tyranny and improving human character. It was felt better to have a large number of small producers who are independent and about of equal strength... Just as the constitution decentralises the power of government both geographically and as between executive, legislative and judiciary, so economic power must be spread."

during the first decade in which the Act was in force. It was not in fact until the administration of President Theodore Roosevelt, beginning in 1901, that emphasis began to be placed on enforcement activities. However the new century was to witness huge changes in the area of economic regulation.

6.2.2 Economic Regulation Immediately Prior to and During the New Deal Era

The period just prior to the New Deal era witnessed some growth in the powers of regulatory commissions. The ICC was given additional jurisdiction by legislation in 1920. In 1922 a Commodities Exchange Authority was established. This was followed by a Federal Radio Commission in 1927 and a Federal Power Commission in 1930, as was noted in part 6.1.2 above.

The first quarter of the 20th century is sometimes described as the progressive era in US political history. In the regulatory area the federal and state governments were engaged in enacting legislation of a social nature in the industrial and commercial areas. An attempt was made to eliminate child labour in factories, to set minimum wages and maximum hours of work, and to regulate prices. This was accompanied by the introduction of an income tax in the closing years of the 19th century. The progressive movement favoured legislative intervention and the use of economic instruments such as taxes, subsidies and other incentives. It displayed a degree of suspicion as to the ability of the common law to adapt to the needs of public policy. On the other hand the progressive tradition was not essentially collectivist in nature. While it recognised the legitimacy of distributional concerns and the need for accompanying

35. This situation is partly explained by the fact that in 1890 the Solicitor General's office employed only eighteen lawyers to carry on litigation before the Supreme Court and all other courts in the United States, a workload which even then far outstripped the resources of the office. (See Letwin, supra note 29, p 103.)

corrective action, it envisaged that such measures would be carried out within the
general framework of a healthily functioning market economy. Progressive ideals have
recently enjoyed some resurgence of popularity in US academic circles, as scholarship
in this area in recent years illustrates.  

The adequacy of then existing legislative initiatives in the economic and social area
was sorely tested during the ensuing period of the Great Depression. During this period
of the 1930s the use of regulatory commissions gained ground as part of the New Deal
reforms. The hostility which manifested itself during this period between the Supreme
Court and President Roosevelt's Administration, leading to the President's abortive
attempt to 'pack' the Court in 1935-1936, is well known and has been described in
detail by others. The root cause of this situation was the perception on the part of
Roosevelt and his administration that a conservative judicial approach to the
constitutionality of the New Deal reforms was serving to hinder economic recovery.

In a series of cases dealing with the New Deal legislation the US Supreme Court had
held that the statutes in question were unconstitutional and invalid as amounting to a
delegation of what was, in the Court's view, essentially a legislative power which could
be properly exercised only by Congress. A brief outline of the relevant constitutional
provisions is of assistance here.

It is convenient to begin by making some mention of the doctrine of separation of
powers. The concept of distributing the essential classes of government function
among different bodies, which is one of the defining characteristics of a federal system,
predates the United States experience, and goes back at least to the time of Aristotle,

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37. See for example Kolko, *The Triumph of Conservatism* (Princeton UP, NJ, 1963); Sunstein,  
supra note 3; Rose-Ackerman, *Rethinking the Progressive Agenda: The Reform of the American  

38. See for example Pusey, *The Supreme Court Crisis* (Macmillan Co, New York, 1937);  
McGarity, "Regulatory Reform and the Positive State: An Historical Overview" (1986) 38  
Admin LR 399; Maidment, *The Judicial Response to the New Deal: The US Supreme Court and  
oneconomic regulation 1934-1936* (Manchester UP, Manchester and New York, 1991); Schwartz,  
*Administrative Law* (Little, Brown & Co, Boston, 3rd ed, 1991), chapter 2; Breyer and Stewart,  
supra note 3; Kerwin, *Rulemaking: How Government Agencies Write Law and Make Policy*  
who wrote of such a method of government.\textsuperscript{39} The better known analysis of the concept is that of Montesquieu, who wrote of the three kinds of powers as early as 1748.\textsuperscript{40}

This so-called doctrine of the separation of powers is one which has been much misconstrued, deliberately and otherwise, by subsequent observers. Indeed, it is likely that Montesquieu merely intended to describe the division of government into three broad categories. He certainly never expressed the view that the functions of government were to be exclusively and rigidly carried on by the branch primarily responsible for any one particular function, as later writers such as Sir Ivor Jennings have correctly pointed out.\textsuperscript{41} Jennings showed that the boundaries between legislative, executive and judicial functions were by no means clear cut and that the growth of the administration in more modern times had served to complicate the position further.\textsuperscript{42}

In the United States context both the federal and state constitutions provide for the separation of governmental functions into three basic divisions: legislative, executive and judicial.\textsuperscript{43} The US Constitution itself does not specifically forbid the delegation of


\textsuperscript{40} Montesquieu, \textit{The Spirit of Laws} (trans Thomas Nugent, Robert Clarke & Co, Cincinnati, 1873, first published 1748), book XI, chapter VI at 173: "In every government there are three sorts of power: the legislative; the executive, in respect to things dependent on the law of nations; and the executive, in regard to matters that depend on the civil law. By virtue of the first, the prince or magistrate enacts temporary or perpetual laws, and amends or abrogates those that have been already enacted. By the second, he makes peace or war, sends or receives embassies, establishes the public security, and provides against invasions. By the third, he punishes criminals, or determines the disputes that arise between individuals. The latter we shall call the judiciary power, and the other simply the executive power of the state."

\textsuperscript{41} Jennings, \textit{The Law and the Constitution} (University of London Press, London, 1933) at p 7: "Montesquieu said nothing of the sort. Nor has there ever been any such division in England. For, to take one example only, the functions of the courts in connection with the criminal law have never been limited to the interpretation of the law. They enforce it. This does not mean, of course, that the judge personally arrests the felon, tries him for the offence, and then personally puts him in gaol and keeps him there until his sentence is completed. The judge or justice gives the orders, and they are carried out by ministerial officers who for this purpose are under his control." See also Allen, \textit{Law and Orders} (Stevens & Sons, London, 3rd ed, 1965), pp 6-16.

\textsuperscript{42} Jennings, \textit{ibid}, chapter 1.

\textsuperscript{43} Thus the \textit{United States Constitution} provides in Art 1, §1: "All legislative powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives." Under Art 1, §8, Congress is empowered "to make all laws which shall be necessary and proper for carrying into execution" its general powers. Art 2, §1 provides that: "The executive power shall be vested in a President of the United States of America" and Art 3,
legislative power by Congress or the exercising by officers of one department of functions primarily pertaining to another department. However the American courts have consistently held that such a situation is the logical result of the express distribution of government powers among the three divisions.\(^4^4\)

Nevertheless it was appreciated at an early stage in United States legal history that defining the line separating the legislative and administrative functions could be extremely difficult in practice.\(^4^5\) The US courts recognised that it was therefore unrealistic to construe the doctrine of separation of powers as requiring an absolute separation of government functions between the three departments, as such a result would make constitutional government impossible, rather than efficient.\(^4^6\)

In the context of administrative agencies, the US courts held in subsequent cases that it was not a misuse of the legislative power to delegate an authority or discretion to be exercised under and in pursuance of that power. The working out in detail of a statutory policy could therefore validly be left to the discretion of administrative agencies provided that the empowering Act sufficiently indicated the legislative purpose, even where the administrative body was required to exercise its own discretion and judgement in implementing the power. Even if the legislature could have dealt with the subject adequately this did not in itself negative its right to delegate the matter to an administrative body to deal with in accordance with that body's own rules and regulations.

\(^{\text{§ 1, confirms that:}}\) "The judicial power of the United States shall be vested in one Supreme Court and in such inferior courts as the Congress may from time to time ordain and establish."

44. See for example Re Laswell 1 Cal App 2d 183, 36 P 2d 678 (1934), where the Court observed: "The United States Constitution contains no specific prohibition against the delegation of the legislative powers of Congress, but it is logically deduced that since the constitution divides the government into three distinct divisions, it does not lie in the power of Congress to delegate its power to another governmental division."

45. Wayman v Southard 10 Wheat. 1 (1825); United States v Grimaud 220 US 506 (1911).

46. As the Pennsylvania Court said in the leading case of Locke's Appeal 72 Pa 491, 13 Am Rep 716 (1873): "The legislature cannot delegate its power to make a law; but it can make a law to delegate a power to determine some fact or state of things upon which the law makes, or intends to make, its own action depend. To deny this would be to stop the wheels of government. There are many things upon which wise and useful legislation must depend, which cannot be known to the law making power, and must, therefore, be a subject of inquiry and determination outside of the halls of legislation."
While the relevant principles were reasonably clear at the theoretical level they had the potential to attract controversy in practice, as the cases on the New Deal legislation showed. In the leading example of *Panama Refining Company v Ryan* the Supreme Court struck down a delegation of power under a provision of the National Industrial Recovery Act 1933 which authorised the President to prohibit inter-state transportation of petroleum products in excess of specified quantities (so called 'hot oil'). The Court held that the conferring by Congress of regulation making powers on executive officers, including the President, was a valid delegation of legislative power only when it fell within the framework of a policy which had previously been defined with adequate clarity by the legislature.

Justice Cardozo, dissenting, held that the delegated power was sufficiently clearly circumscribed "both as to subject matter and occasion", bearing in mind the situation of national emergency which then presented itself, as to amount to a justifiable delegation of power by Congress to the President. This case was only one example. The Supreme Court also struck down other New Deal legislation over this period.

All of this serves to explain the continuing antipathy between the executive and the judiciary during the mid 1930s, as Professor Sunstein has observed. This opposition from the Roosevelt Administration to perceived judicial rigidity blocking the path of

47. 293 US 388 (1935).

48. *Ibid* p 430: "If §9(c) [of the National Industry Recovery Act of 1933] were held valid, it would be idle to pretend that anything would be left of limitations upon the power of the Congress to delegate its law-making function. The reasoning of the many decisions we have reviewed would be made vacuous and their distinctions nugatory. Instead of performing its law-making function the Congress could at will and as to such subjects as it chooses transfer that function to the President or other officer or to an administrative body. The question is not of the intrinsic importance of the particular statute before us, but of the constitutional processes of legislation which are an essential part of our system of government."


50. Sunstein, *supra* note 3, at p 21: "The New Deal reformers thought that the common law was inadequate as a system of regulation not because it was a governmental choice as such, but because it was economically disastrous, insulated established property rights from democratic control, failed to protect the disadvantaged, and disabled the states and the national government from revitalizing or stabilizing the economy. These claims of course took on central importance in the face of the Depression, with a substantial part of the population facing long hours, low wages, or unemployment."
economic reform led inevitably to a gradual transfer of legislative power from the state to the federal level, accompanied by an expansion of the federal bureaucracy. There was contemporaneous growth in the number of administrative agencies, in areas as diverse as public works, employment, social security, labour relations and financial services regulation.\footnote{Sunstein, who refers to the developments during this era under the heading "New Deal Constitutionalism" summarises these initiatives at \emph{supra} note 3, pp 20-24.}

It is noteworthy that the New Deal era also witnessed the increased use of government sponsored enterprises. Some prominent examples of these were the Tennessee Valley Authority, or TVA, (established in 1933 to generate and sell electricity and institute flood control measures), the Reconstruction Finance Corporation (established in 1932 to make commercial loans to promote economic recovery), the Public Works Emergency Housing Corporation (established in 1933 to institute a low cost housing programme) and a number of similar entities.\footnote{For a discussion of the government owned corporations established during this period in the United States see Thurston, \textit{Government Proprietary Corporations in the English-Speaking Countries} (Harvard UP, Cambridge, Mass, 1937), chapter 1, pp 12-18. For a general treatment of the subject of United States public corporations see Abel, "The Public Corporation in the United States" in Friedmann and Garner (eds), \textit{Government Enterprise. A Comparative Study} (Stevens & Sons, London, 1970), chapter 11; Mitnick, \textit{The Political Economy of Regulation} (Columbia UP New York, 1980), chapter 4.}

The constitutional issue of whether the powers of the Federal government extended to the establishment of independent statutory corporations had been resolved in the United States as early as 1819, when the Supreme Court had upheld the establishment of a nationally operated bank as falling within the powers conferred on the federal government by the Constitution.\footnote{See \textit{McCulloch v Maryland} 4 Wheat. 316 (1819).} However, the operation of government owned enterprises such as the TVA often proved to be controversial in practice. The concept of investing a statutory authority with wide ranging powers in relation to land use, bearing more than a passing resemblance to those exercised by centrally planned economies, did not sit well with some sections of American political opinion. Furthermore, the occasional tendency of the TVA to lose its way amidst bureaucratic wrangling periodically impaired its effectiveness. The relationship between the TVA and other government agencies and agricultural lobby groups was frequently strained in
practice, as Selznick has described in his leading analysis of the operation of the Authority.54

The academic literature of that time confirms the comparative novelty of the concept of government ownership of business in the United States. Academic commentators concerned themselves with analysing the extent to which the concepts of private corporation law could adequately be applied to government-owned corporations, which might not be incorporated solely to pursue goals of profit maximisation but which could conceivably also have wider social and economic incentives.55 However a movement away from direct government involvement in commercial activity through the mechanism of government owned corporations was well under way in the United States before the privatisation movement achieved prominence in other Western economies during the 1980s.

Post-war US administrations, such as that of President Eisenhower in the 1950s, began to direct federal agencies to contract with private firms for the provision of goods and services. This policy was progressively reaffirmed by subsequent administrations, becoming enshrined in a formal Executive Order issued in 1978.56 This development, coinciding as it did with the movement towards deregulation which was a feature of the

54. See Selznick, *TVA and the Grass Roots: A Study in the Sociology of Formal Organization* (University of California Press, Berkeley and Los Angeles, 1949). At p 263 Selznick noted: "In the exercise of discretion in agriculture, the TVA entered a situation charged with organizational and political conflict. ... Under the pressure of its agriculturists, the Authority did not recognize Farm Security Administration and sought to exclude Soil Conservation Service from operation within the Valley area. This resulted in the politically paradoxical situation that the eminently New Deal TVA failed to support agencies with which it shared a political communion, and aligned itself with the enemies of those agencies." An earlier, more supportive, view of the TVA can be found in Finer, *The TVA: Lessons for International Application* (ILO, Montreal, 1944). For a more recent description of the legal structure of the TVA see Wirtz, "The Legal Framework of the Tennessee Valley Authority" (1976) 43 Tenn LR 573.

55. See for example Field, "Government Corporations: A Proposal" (1935) 48 Harv LR 775 at p 787, where the author noted: "It has been pointed out by one writer that one of the primary purposes of some government corporations is to make a profit, but it should be added that the primary purpose of most government-owned corporations is not that, and that it is questionable whether that can be a justifiable primary purpose of government corporations as a class except in a socialized State or in a period of transition towards such a State." Field suggests that these various difficulties could be resolved by a suitable federal statute, to be passed after careful study of the various implications of government ownership of corporations. (See p 796.) For further discussion along similar lines see Editorial Note, "Government Corporations in Business" (1932) 32 Col LR 881; Lilienthal and Marquis, "The Conduct of Business Enterprises by the Federal Government" (1941) 54 Harv LR 545.

56. Executive Order No 12,615 issued on 19 November 1978.
Reagan years, indicates that the use of the government-owned public corporation as a regulatory device in the United States is likely to be of considerably less significance in the future than in the case of most other Western economies.^^

6.2.3 The Rise of the Regulatory Agency

(i) Growth of Agencies

As has been noted above, regulatory agencies and commissions grew in popularity during the 1930s, due in no small measure to the harsh economic climate which followed the share market crash of October 1929. This trend was evident in a number of areas, as was noted in part 6.1.2 above.

The concept of widespread economic regulation by administrative agency was not uncontroversial, even in those early days. Perhaps understandably, one of its more vocal opponents was the American Bar Association, which trenchantly criticised these initiatives through its Special Committee on Administrative Law. The ABA was concerned (at least ostensibly) with whether or not the new agencies were constitutionally legitimate and the reports of the Special Committee expressed concern that the new structures could lead to an abuse of power.^^

The reference in the above excerpt to the removal of "large fields of legal controversy from the jurisdiction of the courts" and the whole tenor of the passage might prompt an


58. (1934) 59 ABA Rep 549; "Having in mind these tendencies to attempt to remove large fields of legal controversy from the jurisdiction of the courts and to place them under administrative machinery, to deprive administrative tribunals of safeguards necessary to the exercise of judicial functions, to reduce and so far as possible to eliminate effective judicial or independent review, and to employ indirect methods of adjudication, the committee believes that it is not going too far to state that the judicial branch of the federal government is being rapidly and seriously undermined and, if the tendencies are permitted to develop unchecked, is in danger of meeting a measure of the fate of the Merovingian kings. The committee naturally concludes, so far as possible, the decision of controversies of a judicial character must be brought back into the judicial system."
uncharitable reader to think that the Special Committee of the ABA was less concerned with constitutional niceties than with the volume of work which appeared to be in potential danger of being removed from ABA members. However, as matters turned out, the rise of administrative regulation in the United States proved in the longer term to be much more of a blessing than a curse for the American legal profession. Far from the judicial branch sharing the unhappy fate of the Merovingian kings, as the ABA's Committee feared, it went on to assert broad powers of judicial review over the activities of administrative agencies, an outcome which has no doubt gladdened the hearts of many American lawyers in the ensuing years.

(ii) Early Proponents of Administrative Regulation - Landis and Others

In the first quarter of the present century, US academic writers came to appreciate the theoretical significance of administrative regulation. Thus Professor Dickinson, writing in 1927, recognised the inevitability of increasingly comprehensive administrative regulation through tribunals, boards and other regulatory authorities, allowing for preventive, rather than solely remedial, action, and the adoption of flexible, discretionary rules.

59. The Committee's observations are reminiscent of those of Lord Hewart in his book *The New Despotism* (Ernest Benn Limited, London, 1929) at p 154 where he noted: "And why should the whole scheme and system be so contrived as to oust the superintendence and jurisdiction of the Courts? The complaint is not that rules and regulations are made, though they are made, to be sure, in the most embarrassing multiplicity. The complaint is that they are made at such a stage, in such a form, and in such circumstances as to deprive, at one and the same time, both Parliament and the Law Courts of any real authority in relation to them. The citizen is delivered over to the department. The department becomes judge in its own cause. And the measure which produces these results is itself the handiwork of the department."

60. For those who may be interested in the ABA Committee's rather esoteric reference to the fate of the Merovingian kings, the Merovingian dynasty died out in France with King Childeric III, deposed in AD751 by Pepin the Short, who usurped the throne with the support of the Pope. King Childeric was imprisoned and his ritualised long hair, from which Samsonian powers were believed to flow, was shorn off at the Pope's express command. For an account of these events see the controversial book by Baigent, Leigh and Lincoln, *The Holy Blood and the Holy Grail* (Jonathan Cape Limited, London, 1982), chapter 9.

61. See Dickinson, *Administrative Justice and the Supremacy of Law in the United States* (Harvard UP, Cambridge, Mass, 1927), pp 14-15: "The particular advantages which a system of regulation by government thus has over one of regulation by law differ in the different fields of regulation, but the differences are in the matter of emphasis; the respective advantages fall, with greater or less incidence, under one or more of the following heads:
Perhaps the foremost among the early United States proponents of the use of administrative tribunals in government was Professor James M Landis, a Harvard law professor and later the Dean of Harvard Law School from 1936 to 1946. In his leading work on the subject, published in 1938, Landis outlined a theory of the use of such tribunals and their relationship to the legislative and judicial branches. Landis took the view that the administrative process was not simply a veiled extension of executive power but was of a quite different character. He contrasted the administrative and the executive powers in terms of both scope and responsibility.

(1) Regulation by government opens a way for action to be taken in the public interest to prevent future harm where there would be no assurance that any action would be taken if the initiative were left wholly to interested individuals.

(2) It provides for action that will be prompt and preventive, rather than merely remedial, and will be based on technical knowledge which would not be available if it were taken through the ordinary courts of law.

(3) It ensures that the action taken will have regard for the interests of the general public in a way not possible if it were only the outcome of a controversy between private parties to a law-suit.

(4) It permits the rules for the prevention of socially hurtful conduct to be flexible rules, based on discretion, and thus makes possible the introduction of order in fields not advantageously admitting the application of rules of a rigid and permanent character.”

See Landis, The Administrative Process (Yale UP, New Haven, Connecticut, 1938). For a discussion of the work of Landis in the regulatory area see McCraw, supra note 34, chapter 5, who deals in particular with the contribution of Landis to the formation of the Securities and Exchange Commission in 1933; Koch, "James Landis: The Administrative Process" (1996) 48 Admin LR 419. For an interesting biography of Landis, which contrasts his public achievements as a New Deal and wartime administrator with his unsettled private life, see Ritchie, supra note 38. Rarely has any public figure climbed so high and fallen so low as James McCauley Landis. From a distinguished career as a Harvard law professor and subsequently the Dean of Harvard Law School and a leading government administrator during the New Deal and World War II, his later life was bedevilled by a succession of unfortunate events, as Ritchie's biography reveals. These included a scandalous divorce, which forced his resignation as Dean of Harvard Law School in 1946, increasing alcoholism, a term of 30 days imprisonment imposed in September 1963 for failure to file tax returns, his consequent disbarment for a year by the New York Bar in July 1964 and his death later that same month in dubious circumstances in the family swimming pool. As a final indignity the IRS took possession of his house and property on account of arrears of taxes, including the back garden in which his ashes had been scattered at his own request!

Landis, ibid, pp 15-16: "But the administrative differs [from the executive power] not only with regard to the scope of its powers; it differs most radically in regard to the responsibility it possesses for their exercise. In the grant to it of that full ambit of authority necessary for it in order to plan, to promote, and to police, it presents an assemblage of rights normally exercisable by government as a whole. Moreover, its characteristic is this concept of government, limited, of course, within those boundaries derived from its constituent statutory authority. But administrative power, though it may begin as an effort to adapt and make efficient police protection within a particular field, moves soon to think in terms of the economic well-being of an industry. The creation of that power is, in essence, the response made in the light of a tripartite political theory to the demand that government assume responsibility not merely to
Landis considered that the absence of equal economic power between industry groups and the consumers of their services, a situation particularly pronounced during the unsettled period of the 1930s, justified the widespread deployment of administrative agencies and economic planning at the administrative level. He thought that the judicial process was too narrowly based to permit full appreciation of the background of economic disputes and economic offences of a regulatory nature. In his view administrative tribunals with jurisdiction to look beyond the formal disputes raised by the parties themselves were necessary in order to adjudicate on such cases.

So far as the relationship of the administrative tribunals to the legislative arm of government was concerned, Landis believed that no conflict was involved providing the empowering legislation was well expressed and the legislative policy was sufficiently clearly thought out so that the role of the administrative tribunal was adequately defined. On the subject of enforcement he considered that "intelligent co-ordination between policy-making and enforcement", in the context of an administrative process containing reasonable checks and balances, provided the optimal solution. The ultimate constraint was the power of judicial review, but other checks and balances were also inherent in the administrative process. These included the comparative narrowness of the field to be covered, the availability of guidance from rules and precedents in any particular case and the necessity for sufficient factual findings to exist in order to support an administrative decision.

In terms of their relationship to the courts, Landis considered that administrative agencies should be subject to judicial review in proper cases. However, he believed that determinations within the sphere of competence and legal jurisdiction of a particular tribunal ought to be treated with deference by the courts, an issue which remains the subject of considerable debate half a century later. In particular, he

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64. Ibid, pp 34-37.
considered that administrative findings of fact by expert members of a tribunal could be expected to be as reliable as any decision on those issues reached by a judge.  

Overall, Landis viewed the rise of the regulatory tribunal through a lens which, with the benefit of more recent hindsight, may appear excessively rose-tinted. Certainly his unerring faith in the administrative tribunal as a general cure-all permeates his book. He was of course writing at a time when most of the US regulatory commissions were in their infancy and before spectres such as regulatory capture, improper industry influence and failure to fulfill cost-benefit criteria became the subject of informed debate. Others who came later were to be somewhat more outspoken in their criticism of the process of administrative regulation. As Bernstein subsequently wrote, the argument of Landis in favour of decision making by expert commissions (as opposed to inexpert judges) did not necessarily survive rigorous analysis. Just as Talleyrand is said to have observed that war is much too serious to be left to the generals, perhaps regulation is much too serious to be left to the regulators.

6.2.4  The Evolution of the Administrative Procedure Act

Even during the 1930s, when the new structures were in their infancy, the degree of delegated authority conferred on regulatory agencies and the sweeping manner in which some of those powers were exercised gave rise to concern. In its famous description of the regulatory agencies in 1937 the Brownlow Committee (officially called the Attorney

67.  Ibid, p 142: "The positive reason for declining judicial review over administrative findings of fact is the belief that the expertness of the administrative [process], if guarded by adequate procedures, can be trusted to determine these issues as capably as judges."

68.  Ibid p 46: "The administrative process, is, in essence, our generation's answer to the inadequacy of the judicial and the legislative processes. It represents our effort to find an answer to those inadequacies by some other method than merely increasing executive power. If the doctrine of the separation of power implies division, it also implies balance, and balance calls for equality. The creation of administrative power may be the means for the preservation of that balance, so that paradoxically enough, though it may seem in theoretic violation of the doctrine of the separation of power, it may in matter of fact be the means for the preservation of the content of that doctrine."

69.  Bernstein, Regulating Business by Independent Commission (Princeton UP, Princeton, New Jersey, 1955), p 119: "But he [Landis] carries his argument too far. A singleness of concern and the development of a professional spirit have led not to balanced judgement ordinarily, but to excessive emphasis on narrow technical considerations and to struggles between professional groups or status in influencing and determining the course of regulatory policy."
Generals Committee on Administrative Procedure), established by President Roosevelt to review administrative practices by government agencies, referred to the agencies as the "headless fourth branch of government", a description which has retained its popularity and which was adopted by the US judiciary in at least one subsequent case.

Congress mounted a challenge to the jurisdiction of the administrative agencies in the Walter-Logan Bill of 1940, which attempted to subject administrative actions by agencies to judicial review in a federal administrative court to be specially established for the purpose. President Roosevelt foresaw some of the wider implications behind the measure, in terms of the Congressional attempt to curtail Presidential freedom of action, and vetoed the Bill, a move which was not challenged by Congress.

Roosevelt, however, recognised that concern over the powers of administrative agencies was unlikely to be a passing phenomenon and convened an advisory commission, in the form of the Attorney Generals' Committee on Administrative Procedure, which has been referred to above. In its 1941 report, Administrative Procedures in Government Agencies, the Committee drew attention to the need for administrative decision making by agencies to be based on clearly defined statutory authority. The passage of the necessary legislation was delayed by wartime exigencies, but a statute was finally enacted as the Administrative Procedure Act 1946.

The Administrative Procedure Act ("APA") basically categorises administrative procedure into rule making activities, adjudication and other tasks of an administrative

70. Quoted in Cooper, Public Law and Public Administration (Mayfield, Palo Alto, California, 1983), p 75.
72. For a discussion of these events see Kerwin, supra note 38; McGarity, supra note 38, pp 404-406.
73. For a description of the background to the passage to this legislation and its basic provisions, see Bernstein, supra note 69, pp 192-211; Breyer and Stewart, supra note 3, pp 22-25; Schwartz, supra note 38, chapters 6 and 7.
nature such as the implementation of programmes and policies. The essential nature of these processes has been succinctly summarised by Kerwin.74

In later parts of this chapter, such as those dealing with rulemaking procedures, some of the provisions of the APA will be examined in greater detail. However, it should be noted at this point that, in bringing about a resolution of much of the ongoing dispute in the United States between the opponents and proponents of more extensive administrative decision making, the legislation represented a remarkable achievement, and one which has not diminished in importance in the succeeding years.75

6.2.5 US Regulation from 1945 to 1980

The post-war experience with United States regulation reveals an increase in regulatory oversight during the 1960s and 1970s, followed by a reversal of this trend in the 1980s. During the former period, which is marked by what Sunstein describes as a "revolution in the category of legally protected rights",76 the influence of the civil rights movement combined with greater judicial recognition of individual constitutional rights and entitlements was matched by corresponding initiatives in the regulatory area. These included comprehensive automobile safety legislation in 1966, a wide variety of regulatory measures in the environmental area (including the Clean Air Act, the Clean

74. Kerwin, supra note 38, p 50: "In the simplest terms, the APA requires agencies to behave like a legislature when they write rules and like courts when they adjudicate disputes. Everything else is left essentially to the discretion of the agencies. Looked at from this perspective, the New Dealers succeeded in capturing much of the making and all of the implementation of policy and law for their political philosophy. America's historical penchant for an independent judiciary, with its distinctive and elaborate methods for making decisions, would, however, be preserved. Adjudication in agencies was to be conducted in the manner of a civil trial presided over by a judicial officer whose objectivity was to be guaranteed through his or her structural and functional separation from the other activities and personnel of the agency." For a discussion of the philosophy underlying the APA see Shapiro, "APA: Past, Present and Future" (1986) 72 Virg LR 452; Beermann, "The Reach of Administrative Law in the United States" in Taggart (ed), The Province of Administrative Law (Hart Publishing, Oxford, 1997), chapter 9.

75. For a useful discussion of the historical importance of the APA in the evolution of administrative processes see McGarity, supra note 38, pp 403-407.

76. Sunstein, supra note 3, p 24.
Water Act and the National Environmental Policy Act) and various measures in the occupational health and safety area.\textsuperscript{77}

These regulatory initiatives in new areas of economic and social activity were accompanied by developments at the level of analytical theory. Professor Reich, for example, adopted an innovative approach in his well known 1964 article in the Yale Law Journal entitled "The New Property".\textsuperscript{78} He took the view that the various forms of wealth provided by modern government in the form of "money, benefits, services, contracts, franchises and licenses"\textsuperscript{79} constituted a new form of property which was becoming increasingly more significant than the traditional forms of property right. The possibility of the distribution of such largesse becoming a source of arbitrary government action required the continuing development of administrative law techniques, including judicial review.\textsuperscript{80}

During the 1950s, as was noted earlier in this chapter, commentators such as Professor Schwartz had identified the six major federal regulatory agencies, which came to be known as the "Big Six" agencies.\textsuperscript{81} In the 1960s new agencies such as the Environmental Protection Agency (EPA), the Occupational Safety and Health Administration (OSHA), the Consumer Product Safety Commission, the Equal Employment Opportunity Commission, the National Transportation Safety Board and other similar bodies also came into being.

\begin{itemize}
\item 77. For a summary of these regulatory measures see Sunstein, \textit{supra} note 3, pp 25-29.
\item 78. Reich, "The New Property" (1964) 73 Yale LJ 733, which apparently has the distinction of being the most widely cited article in the Yale Law Journal - see Shapiro, "The Most-Cited Articles from the Yale Law Journal" (1991) 100 Yale LJ 1449 at 1462.
\item 79. \textit{Ibid} 733.
\item 80. \textit{Ibid} 783: "The grant, denial, revocation, and administration of all types of government largesse should be subject to scrupulous observance of fair procedures. Action should be open to hearing and contest, and based upon a record subject to judicial review. The denial of any form of privilege or benefit on the basis of undisclosed reasons should no longer be tolerated."
\item 81. Schwartz, \textit{supra} note 4, p 23. At that time the "Big Six" agencies were the Civil Aeronautics Board (now defunct), the Federal Communications Commission, the Federal Power Commission (now the Federal Energy Regulatory Commission), the Federal Trade Commission, the Interstate Commerce Commission and the Securities and Exchange Commission.
\end{itemize}
These initiatives were matched by a huge expansion in regulatory expenditure during the 1970s. From a total of US$866m in 1970, the figure rose to more than US$5.5bn in 1979. As was also noted above, this was matched by a corresponding increase in the size of the daily US Federal Register in the period to 1980. However, the emphasis in US regulatory philosophy during this period differed considerably from that which had been evident during the New Deal era.

Whereas the era of the Great Depression had been characterised by regulatory measures aimed at stabilising the economy and restoring business confidence, during the 1960s and 1970s Congress was more concerned withremedying public health and safety risks of various kinds as well as addressing the position of the socially disadvantaged. Furthermore Congress was more conscious of the dangers of unrestrained agency autonomy and was much less willing to endorse the broad New Deal approach, where authorities were frequently authorised to prevent "unreasonable" behaviour and to act "in the public interest", mandates which frequently brought the administration and the judiciary into conflict in the 1930s, as was noted above. The regulatory regimes put in place during the 1970s, in particular, were also quite avant garde in terms of their areas of coverage, with correspondingly increased complexity in terms of the accompanying rulemaking requirements as Kerwin has noted.

82. Supra note 2.

83. See the discussion in part 6.2.2 above. For an interesting comparison between the political considerations underlying economic regulation during the New Deal period of the 1930s and subsequently during the 1970s (both periods being ones in which a Democratic administration was in power) see Sanders "The Regulatory Surge of the 1970s in Historical Perspective" in Bailey (ed), Public Regulation: New Perspectives on Institutions and Policies (MIT Press, Cambridge, Massachusetts, 1987), chapter 4.

84. Kerwin, supra note 38, p 15: "To the volume of work, accelerated pace, and inevitable conflict contained in their delegations of rulemaking authority, the statutes of the 1970s added several layers of substantive and procedural complexity. Environmental and workplace safety programmes are good examples of statutes that sent rulemaking routinely to the edge of human knowledge and technical capabilities and beyond. Agencies were expected to create information, such as that which would establish 'safe' levels of various chemicals and substances, like benzene and asbestos, in the workplace, while simultaneously incorporating that information into a rule that could be implemented, complied with, and enforced. Further, ... Congress became increasingly concerned with the process by which rules were being written by agencies."
The need for predictable standards of administrative decision making began to receive formal recognition in the 1960s. Judge Friendly's contribution should be noted here.\(^\text{85}\) He began from the premise that the primary shortcoming of the regulatory agencies at that time was their failure to develop coherent standards, both in relation to adjudication and rule-making. Friendly analysed the record in this area of the NLRB, FCC, CAB and the ICC. His recipe for improvement was relatively straightforward. He doubted that a better regime could be effected by encouraging the courts to take a more expansive role in relation to judicial review, believing that the judiciary lacked sufficient specialised expertise to take on such a demanding task.\(^\text{86}\)

In his view the primary solution lay in improving the agencies themselves. Friendly thought that this would entail improving the quality and conditions of service of commissioners and staff, combined with greater use of policy statements and rulemaking. He saw these techniques as serving to promote internal and external consistency in decision making, overcoming difficulties arising out of the idiosyncrasies of particular agency administrators and from the political pressures attendant in controversial areas of decision making.\(^\text{87}\) Interestingly also, Friendly did not seek to advocate an extreme view of agency independence vis a vis Congress and the White House. Instead he considered that the President's responsibility under the Constitution to ensure that the laws were faithfully executed extended to ensuring that the agencies were adequately staffed and resourced to be able to carry out their tasks competently and efficiently. However he was also anxious to see that an acceptable middle course was steered between Presidential indifference and Presidential direction.\(^\text{88}\)

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86. *Ibid* 141: "The courts have their function in marking out the allowable limits of agency action. ... But the tastes of a variety of fields of administrative adjudication that we have had must surely have made it clear that the task of defining substantive standards cannot possibly be transferred to the courts either in whole or in any significant part."


88. *Ibid* 149-150: "Having said all this, I still find difficulty in the proposal that the President should not merely see to it that the agencies function but should tell them how. I do not have much
In the case of Congress, Friendly deprecated its unwillingness to lay down better guidelines for agency action through legislation, coupled with the general lack of agency supervision through mechanisms such as standing committees charged with reviewing major regulatory legislation at regular intervals and issuing a comprehensive report. Overall, Friendly's remarkably pragmatic and sensible guidelines deserved greater consideration and implementation than they received. He was one of the first US legal writers in this area to emphasise the benefits of standards in administrative regulation, a theme that was revisited by later advocates of the rule making process, such as Professor Kenneth C Davis, a decade later. His ideas on the proper scope of oversight by the Executive and the Legislature are especially valuable and will be taken up again both in this chapter and in later ones.

6.2.6 Deregulation During the 1980s

By the late 1970s, however, a time of economic recession had become evident. The United States economy was faced with a period of high inflation, an energy crisis and challenges to its international competitiveness, coupled with decreased levels of productivity and employment. This soon led to corresponding calls for a reduction in the level of regulatory controls. An expression of popular opinion to this effect led to deregulatory legislation in the areas of energy (where oil pricing controls were removed) and transportation (where the airline, railroad and trucking industries were substantially deregulated).

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89. Ibid 163-173.

90. For a discussion of these deregulatory initiatives see Breyer, supra note 3, chapters 11, 12, 16 and 17; Peltzman, The Economic Theory of Regulation after a Decade of Deregulation (Brookings Institute, Washington DC, 1989); Vietor, Contrived Competition. Regulation and Deregulation in America (Harvard UP, Cambridge, Massachusetts, 1994); Goodman and Wrightson, Managing Regulatory Reform. The Reagan Strategy and its Impact (Praeger, New York, 1987).
The second significant response to these changed circumstances consisted of an initiative by the Reagan Administration aimed at eliminating or reducing regulatory controls initiated by agencies. Executive Order 12,291 was aimed at introducing cost-benefit considerations into proposed new regulatory measures, including the preparation and consideration of a Regulatory Impact Analysis prepared by the sponsoring agency. This analysis was required to describe the potential benefits of the rule (both monetary and non-monetary in nature) as well as the potential costs of the rule. It also had to contain a determination of the "potential net benefits" of the rule and a description of "alternative approaches that could substantially achieve the same regulatory goal at lower cost."

Another significant Executive Order, No. 12,498, issued in 1985 by President Reagan, was directed at giving the Office of Management and Budget (OMB), express powers of co-ordination in relation to regulatory planning. In particular, the Order required proposed regulatory actions to be "consistent with the goals of the agency and of the Administration" and specified that they must first be submitted to the Director of the OMB for scrutiny. The agency's submission was required to provide sufficient background on the intended regulatory purpose, to explain how the proposed regulations were consistent with the Administration's regulatory principles and to discuss the agency's plans to revise or rescind existing rules covering the area.

It is noteworthy however that Executive Order 12,291, setting out the cost-benefit approach, specifically omitted the independent agencies from its ambit, reinforcing the


94. For the text of the relevant parts of this Order, and a description of its intended operation, see Breyer and Stewart, supra note 3, pp 110-111. See also Goodman and Wrightson, supra note 90, pp 43-44; Friedman, supra note 91, pp 1185-1187.

95. See section 2 of the Order.
independent status of the agencies in terms of their relationship with the executive power, expressed through the office of the President. As a matter of constitutional principle it seems likely that the President could in fact have extended the application of Executive Orders to the independent regulatory agencies, but when such a course was attempted by President Carter in the late 1970s, Congress objected that the President lacked the requisite authority to take such a step.

In the final event a challenge to the constitutionality of this procedure was averted when President Carter decided not to press the point. Subsequent Presidents have not sought to provoke a similar confrontation with Congress on this issue. Indeed, the worm has more recently turned, with the 1995 Session witnessing a Republican Congress seeking to impose a similar regime on the independent agencies in the face of misgivings on the part of a Democrat White House, as the discussion in part 6.4.2 (vi) of this chapter will show.

Experience during the first half of the present decade indicates that an upsurge in rulemaking activity, and indeed in economic and social regulation generally (with some notable exceptions in cases such as air transport), seems to be occurring. Kerwin points, for example, to the likely need for extensive rulemaking activity under statutory provisions such as the new Clean Air Act, introduced in 1990, which the EPA has estimated will require between 300 and 400 rules for its effective implementation.

Other areas where increased economic regulation appears likely are in banking and financial services (following the bailout of the US savings and loan industry at huge expense to the federal Treasury in the early 1990s) and the electric power industry, or at least that part of it which is subject to federal regulation.

96. For a discussion of the significance of this omission see Breyer and Stewart, supra note 3, pp 116-137.


98. See Kerwin, supra note 38, pp 19-20.

However other commentators have pointed to indications that the complexity, expense and delay involved in the US rulemaking process may force agencies to seek other mechanisms for implementing their regulatory programmes. These might include increased use of regulatory negotiation, streamlined internal procedures for the adoption of non-controversial rules and the categorising of rules in terms of significance, leading to differing levels of procedural formality in various cases. These matters will be canvassed in more detail later in this chapter.

On 30 September 1993 President Clinton issued Executive Order 12,866, aimed at introducing a more detailed regulatory planning and review process in relation to federal agency rulemaking. Under this Order, the OMB, through its Office of Information and Regulatory Affairs (OIRA), continues to undertake the previously existing process of regulatory review. However the Vice-President becomes responsible for implementation of the programme and has greater powers of oversight in relation to the activities of OIRA, resolution of disputes between OIRA and the agencies and the identification of regulations which should be the subject of review.

It may be that these developments are indicative of an attempt by the Executive to assert itself as against Congress in this area, and the new Executive Order certainly confers additional powers on the White House in terms of regulatory policy.

It is conceivable that a backlash against some of the procedural excesses of the US regulatory process may occur before the end of the present decade and the form which any resulting changes may take will undoubtedly have significant implications for the regulatory process in the United Kingdom and other jurisdictions. Nevertheless, assuming the continued existence of the APA and associated procedural requirements, which are likely to remain entrenched through the interaction of strongly opposed


102. For a discussion of the terms and effect of Order 12,866, see Shapiro, "Political Oversight and the Deterioration of Regulatory Policy" (1994) 46 Admin LR 1 at 36-38.
interest groups in the American political structure, it would seem that the scope for wholesale changes to the US system of economic regulation is limited, at least in the foreseeable future.

6.3 Theories of the Regulatory Agency

6.3.1 Introduction

This part of the chapter deals with three different theories which have been advanced to explain the underlying motivations and activities of US regulatory agencies and comments on the validity of these theories in the light of the available empirical evidence. These three theories are the capture theory, the self-interest or budget maximising theory and the principal/agent or interest group theory.

The purpose of this exercise is to examine whether one or more of these hypotheses provides a theory of adequate explanatory power in relation to the US independent regulatory agencies, and if so whether such a theory might usefully be applied in the context of regulatory regimes in Britain. Factors such as regulatory capture, which affect the independence and autonomy of regulatory bodies, are matters which have an obvious bearing on the accountability of those bodies and on the foreseeable success of any rule making programme adopted by them. They also affect the degree to which regulatory bodies are likely to be responsive to participative mechanisms involving various stakeholder groups.

6.3.2 Theories of Regulatory Capture

(i) Evolution of Capture Theories

Capture theories, which are based on the central concept that the regulated interests sooner or later come to dominate and dictate policy to the regulatory agency, represent the oldest, and possibly the most controversial, explanation for the behaviour and motivations of the independent regulatory agencies. In the realms of political science, Marx was probably the first theorist to advocate a capture theory of sorts, in that he posited that the owners of capital would seek to extend their influence not only over the
workers (and over each other) but also over the institutions of the state, both nationally and internationally. In the context of US economic regulation, Professor Schwartz has traced expressions of disquiet about possible industry influence on the regulatory commissions to as early as the year 1913, in a report by the Minnesota Home Rule League.

The report went on to allege that the commissioners were selected as a result of their close connections with the regulated companies and their past and prospective services to those companies. This criticism foreshadows the "revolving door" theory, which was put forward some fifty years later and which will be the subject of further discussion below.

The role of certain industry groups, such as the railroad interests in particular, in actively encouraging government regulatory initiatives as a means of excluding competition and entrenching existing market dominance, has already been referred to in chapter 2. Surveying the historical material, Bernstein and other commentators have suggested that regulated industries such as the railroad companies became supporters of the regulatory commission for the principal purpose of promoting their own interests. More recently, critics of the regulatory process such as Stigler have pointed to the reluctance of US regulatory bodies to allow new entrants into a regulated

103. See Marx, Capital, Volume 1 (Penguin Books, London, 1976, first published 1867), chapter 32, "The Historical Tendency of Capitalist Accumulation". At p 929 (Penguin edition), Marx observed: "Hand in hand with this centralization, or the expropriation of many capitalists by a few, other developments take place on an ever-increasing scale, such as the growth of the cooperative form of the labour process ... the economizing of all means of production of combined, socialized labour, the entanglement of all peoples in the net of the world market, and, with this, the growth of the international character of the capitalist regime." Laffont and Tirole, in their recent text on economic aspects of the regulatory process, regard Marx as one of the originators of the concept of capture. See Laffont and Tirole, A Theory of Incentives and Procurement in Regulation (The MIT Press, Cambridge, Mass, 1993), chapter 11, pp 475-476.

104. See the excerpt quoted in Schwartz, supra note 4, p 139: "... [the regulated interests] have used their influence upon the appointing power to name men of 'right' minds on the commission; have sought to influence the attitude and to control the action of the commissions after appointment."

105. See the discussion in part 2.5.3 of chapter 2.

106. See for example Bernstein, supra note 69, chapters 2 and 3; Appleby, Policy and Administration (University of Alabama, Alabama, 1949), p 162.
market as being strong evidence of the dominant influence of industry groups over their regulators.107

During the New Deal era, when the focus of regulatory debate centred on the continuing dispute between the President and the Supreme Court, as well as on the sweeping powers granted to regulatory agencies at a time when US industrial power was at a comparatively low ebb, debate on the concept of regulatory capture was limited. Landis, for example, in his undeniably sanguine approach written in 1938, and discussed earlier in part 6.2.3(ii) of this chapter, largely ignores the possibility of industry domination of regulatory agencies.

(ii) Bernstein's Life-Cycle Theory of Regulatory Capture

It was not until the 1950s that theories of regulatory capture began to receive reasonably comprehensive intellectual exposition. One of the earliest attempts to set out a reasoned theory of regulatory capture was that of Bernstein in his book on the subject published in 1955.108 In Bernstein's view, the independent regulatory commission possessed a natural life cycle which, like the ages of man, could be divided into four phases, which he described as gestation, youth, maturity and old age.

In summary, Bernstein's theory envisaged, first, a gestation period, in which the need for a particular regulatory statute was recognised and affected groups in society made demands of the legislature for corrective action. After the usual convoluted processes legislation was finally enacted and the appropriate regulatory agency was created. This process was often accomplished in the face of opposition from powerful and well resourced industry groups affected by the regulatory measures. Bernstein considered that the ICC and the SEC were two agencies which had come into being in circumstances of the kind outlined in his description of the gestation process.109

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108. Bernstein, supra note 69.
109. Bernstein describes the first phase in the life-cycle of the regulatory commission at ibid pp 74-79.
Phase 2, the youthful phase of the regulatory commission, followed on naturally from the gestation phase. During this phase the regulatory commission was newly established. It sought to begin its career with an "aggressive, crusading spirit", knowing that if it was to act in the public interest it needed to do so at a time when the political climate was sympathetic and the agency could command public support. Often constitutional challenges to the agency's powers might be brought by the regulated interests at this stage. After these preliminary skirmishes had been fought the regulator set about clarifying goals and establishing basic policies. Bernstein considered that bodies such as the FPC and the FCC exhibited these characteristics during the initial years following their establishment.\textsuperscript{110}

Phase 3 of the life-cycle was represented by the age of maturity or devitalisation.\textsuperscript{111} In Bernstein's theory, the third, or maturity phase, generally witnessed a less positive approach on the part of the regulator, with greater emphasis on co-operative procedures rather than on enforcement mechanisms. The influence of industry groups became ascendant and the regulator typically displayed conflict-avoidance behaviour. The maturity phase was also likely to witness internal rivalries within the agency (such as between lawyers, engineers and economists) together with increasingly inflexible bureaucratic procedures. Again, Bernstein considered the ICC to be undergoing its maturity phase at the time he was writing.\textsuperscript{112}

Finally, according to Bernstein, the agency entered phase 4, which was old age and was characterised by debility and decline. The regulatory agency in this phase was primarily concerned with maintaining the status quo and lacked the energy or motivation to undertake any new regulatory endeavours. This was reflected by a correspondingly hostile attitude from government in terms of reluctance to provide adequate funding or levels of staffing. The original regulatory objectives might no longer be appropriate but the government typically showed little interest in redefining

\textsuperscript{110} For Bernstein's treatment of the youth phase of the regulatory commission see \textit{ibid} pp 79-86.

\textsuperscript{111} \textit{Ibid} pp 86-87: "Gradually the spirit of controversy fades out of the regulatory setting, and the commission adjusts to conflict among the parties in interest. It relies more and more on settled procedures and adapts itself to the need to fight its own political battles unassisted by informed public opinion and effective national political leadership."

\textsuperscript{112} For a discussion of the maturity phase see \textit{ibid} pp 86-91.
them. The regulatory commission in old age was likely to stagger along until some
dramatic event, such as a scandal or some form of economic or other emergency, forced
the government to embark on radical regulatory reforms.113

(iii) Critique of Bernstein's Theory

Bernstein sought to demonstrate the validity of his theory by analysing the history of
some of the major US regulatory agencies. Parts of his theory have a certain intuitive
appeal. It is eminently conceivable, for example, that the initial phases of gestation and
youth, in which a newly established regulatory agency finds its feet and explores the
extent of its powers, in legal and constitutional terms, provide a not inaccurate
description of the early stages in the evolution of regulatory agencies. Again it is
foreseeable that over a long period an agency may become set in its ways and
excessively dominated by bureaucratic procedures, perhaps coupled with the desire for
a quiet life, so that its regulatory effectiveness is correspondingly diminished.
However, the inexorable progress of the regulatory agency from the cradle to the grave
is probably much too simplistic a view in so far as it purports to furnish a
comprehensive explanation of the behaviour of the US regulatory agencies, at least in
more recent times.

Some commentators, for example, have pointed out that the political will to ensure the
success of regulatory initiatives (which can readily be reflected through adequate
funding and the provision of suitably qualified and committed staff) is one factor which
Bernstein's theory does not adequately recognise. This can foreseeably fluctuate over
time and may in fact work to strengthen the hand of a regulatory agency in the long run.
Similarly, more recent empirical evidence tends to indicate that few clear patterns of
increasing industry capture or domination of a regulatory agency can generally be
discerned. Freitag, for example, concluded from his study of the subject that the degree
of corporate domination of the regulatory commissions was over-estimated by
Bernstein and others and that there was little empirical evidence to support a "life-

113. For a discussion of phase 4 see ibid pp 91-95.
cycle" theory as a general explanatory model.\textsuperscript{114} Other commentators have advanced similar criticisms.\textsuperscript{115}

It is possible to point to some examples where regulatory capture, to a greater or lesser extent, appears to have occurred in the US regulatory scene. Many of these cases have arisen in the context of industries where the regulated interests exercise exclusive control over the applicable incentives for regulators, a model which is of doubtful validity in the more complex circumstances of modern regulation.

To apply Bernstein's theory to specific cases, some regulatory bodies, such as the Food and Drug Administration, are no strangers to intensive lobbying on the part of drug companies and other industry participants, but the protracted process of approving new drugs and pharmaceutical products in the United States is well known and there is little evidence of industry capture in this area.\textsuperscript{116}

In the case of the Environmental Protection Agency, to take another example, there is again little indication that industry interests have dominated EPA decision making. EPA regulatory procedures have often tended towards achieving a compromise between industry and environmental interests. In fact the EPA has frequently had to mediate between opposing pressure groups in the course of its regulatory activities, a situation involving high levels of public scrutiny in which capture of the agency by a single interest group is unlikely to occur, and would attract widespread adverse comment if it did.\textsuperscript{117}

At the theoretical level, commentators such as Wilson have pointed out that in an era when the legitimacy of business enterprise is no longer taken for granted, the influence of business on regulatory activities can be overemphasised. In his 1980 study of the


\textsuperscript{115} Jaffe, for example, while acknowledging that agencies may become complacent and inactive, considered in his review of Bernstein's book that Bernstein had overstated his case. (See Jaffe, "The Independent Agency - A New Scapegoat" (1956) 65 Yale LJ 1068.)

\textsuperscript{116} For an evaluation of external influences on the Food and Drug Administration see Quirk, "Food and Drug Administration" in Wilson (ed), \textit{supra} note 4, chapter 6, especially at pp 211-218.

\textsuperscript{117} See for example Marcus, "Environmental Protection Agency" in Wilson (ed), \textit{supra} note 4, chapter 8, especially pp 298-298.
subject Wilson noted that it was doubtful whether business interests had ever exercised any substantial influence in this area.\footnote{Wilson (ed), \textit{supra} note 4, chapter 10, p 366: "But even in the heyday of Horatio Alger and popular sermons on the virtues of wealth, there was enough anti-business opinion fomented by the Grangers and the muckrakers to make it difficult for any federal regulatory law to be purely business-serving. If business influence was to be truly successful, it would have to keep a regulatory proposal from being placed on the political agenda in the first place - something which no doubt occurred, but this meant that business thereby forfeited the opportunity to use regulation to maximise profits."}

6.3.3 Possible Types of Regulatory Capture.

(i) Hypotheses of Modern Capture Theory

Probably the most systematic study in recent years of the problem of industry influence on federal regulatory agencies in the United States has been that undertaken by Quirk, published in 1981.\footnote{See Quirk, \textit{Industry Influence in Federal Regulatory Agencies} (Princeton UP, Princeton, New Jersey, 1981).} In his study, Quirk identified three principal hypotheses concerning the nature of possible industry influence on regulatory agencies, which he set about investigating.

The first of these he termed the "pro-industry appointments hypothesis." This theory suggested that holders of high office in the regulatory agencies were selected by reason of industry influence in the appointment process. The appointees would therefore conceivably identify with industry interests after their appointment by reason of their background or known views on the subject of regulation. A weaker form of the theory held that even if the appointment of pro-industry candidates could not be achieved by the regulated interests, the influence of the regulatees was at least sufficiently strong to exclude prospective appointees who were definitely opposed to the interests of industry.

The second hypothesis which Quirk advanced was one which he termed the "pro-industry budgetary incentives hypothesis." Under this theory, it was suggested that regulatory agencies were under budgetary incentives to adopt and pursue policies favourable to industry. This was because failure on the part of the regulators to "toe the
"line" in this way would lead to undesirable consequences, such as budgetary reductions, suppression of their powers or rate of expansion, or at least a greater risk of these outcomes occurring. The validity of this hypothesis does of course assume a pronounced level of industry influence on the processes of government, particularly in so far as they involve appropriations and budgetary matters.

The third hypothesis put forward by Quirk was the "industry job incentives hypothesis." This theory was based on the premise that officials of regulatory agencies would tend to support policies favourable to industry based on personal career considerations, in that they would desire to maximise their opportunities of gaining employment in the regulated industries upon leaving the agencies. Here, the underlying assumption was that regulated industries will be more likely to hire former regulatory officials who have been supportive of industry interests while employed by the regulatory agencies. The observed phenomenon of industry staff moving to and from the regulatory agencies has sometimes been termed the "revolving door", in recognition of the fact that job mobility between industry and the commissions was thought to be a two-way process.\(^{120}\)

(ii) Quirk's Research on US Regulatory Capture

Quirk conducted extensive interviews among the staff of the major US regulatory agencies in relation to his various hypotheses. After a detailed study he found that there was varying support for the differing theories of regulatory capture. The first hypothesis (industry influence to secure the appointment of compliant regulatory officials) attracted little support in the empirical evidence. Quirk noted in fact that the majority of the officials interviewed either opposed industry policies or were ambivalent on the subject.\(^{121}\)

The second hypothesis, which assumed the need to preserve budgetary incentives by pro-industry conduct on the part of the regulatory officials, was supported by some empirical evidence, although the instances in question were quite specific and limited.

\(^{120}\) The three basic hypotheses are described at *ibid*, pp 23-26.

\(^{121}\) *Ibid*, p 175.
On the other hand agencies such as the Federal Trade Commission were found to anticipate budgetary rewards arising from vigorous enforcement policies (the converse situation to that required for the validity of the second hypothesis.) Regulatory actions thought to be harmful in terms of the availability of budget support for the agency sometimes occurred where burdens were imposed on industry, but these generally only arose where there was also tangible inconvenience to consumers. (One example was delays in FDA approval of particular pharmaceutical products.)

The third hypothesis, based on the prospect of securing subsequent industry employment, attracted more empirical support. However, even here the picture was not particularly clear-cut. Quirk observed, for example, that in the case of the FTC, "the best private opportunities for FTC officials are believed to go to those who are most productive of strong enforcement."  

6.3.4 Evaluation of the Validity of Capture Theories in the United States Context

Empirical support for capture theories in the United States is therefore somewhat ambivalent. While there are well-documented individual instances the explanatory power of the theory as a general model of regulatory behaviour appears limited. The overall conclusion which Quirk drew from his study was that theories which assumed that regulatory agencies tended to favour, or were closely influenced by, regulated industry interests, had to be regarded with scepticism. He reached the view that his research weighed against the validity of theories of agency capture, which he believed were insufficiently sophisticated models of regulatory behaviour.  

As noted above, there have undoubtedly been specific instances where the occurrence of regulatory capture, or a strong suspicion of its occurrence, have been identified. Professor Schwartz identified some of these in his account of his experience during the 1950s as Chief Counsel to the House Subcommittee on Legislative Oversight. In

122. Ibid, p 177.
123. Ibid, p 177.
more recent times critics such as the consumer advocate, Ralph Nader, have accused regulatory agencies of having been captured by industry interests where, in his view, they had not taken a sufficiently vigorous stand on behalf of consumers or employees.\textsuperscript{125}

Some studies of the "revolving door" phenomenon have tended to the conclusion that party differences are generally more cogent indicators of the orientation of individual members of regulatory commissions than factors such as previous or prospective employment in the regulated industry. In his study of FCC members, Gormley tested the revolving door hypothesis in relation to the regulatory performance of individual commissioners.\textsuperscript{126} He concluded that a prospective appointee's political affiliations were likely to be more significant than his or her business ones.\textsuperscript{127}

Similar weak empirical support for the revolving door theory was found by Makkai and Braithwaite in their investigation into nursing home regulation in Australia.\textsuperscript{128} After studying the characteristics of nursing home inspection policies in Australia, they concluded that capture theories, based on the revolving door hypothesis, were largely unsupported on the evidence. They did however find that inspectors who took a stronger enforcement line were more likely to leave the regulatory agency than less rigorous inspectors. Nevertheless, there was very weak correlation between this result

\textsuperscript{125} Green and Nader, "Economic Regulation versus Competition: Uncle Sam the Monopoly Man" (1973) 82 Yale LJ 871. See also Lowi, \textit{The End of Liberalism} (W Norton & Company, New York, 2nd ed, 1979), who attributed the existence of regulatory capture to an inability on the part of Congress to choose from among conflicting social goals when establishing regulatory agencies. Lowi summed up his views at p 281 as follows: "Going beyond these specific policies, the basic argument of this book has been that any and all discretionary policies will tend to give us a receivership effect because discretionary policies develop a particular kind of politics which is supportive of the clientele it seeks to deal with. The only explicit departure from this general thesis is that certain important regulatory policies explicitly, self-consciously and systematically intend to produce this result."

\textsuperscript{126} See Gormley, "A Test of the Revolving Door Hypothesis at the FCC" (1979) 23 Am J Pol Sc 665.

\textsuperscript{127} \textit{Ibid} 681: "The appointment of a former broadcaster to the FCC is likely to be less significant than a change in the party controlling the White House - a change which permits the party balance at the agency to tilt from a majority of Democrats to a majority of Republicans or vice versa. This suggests that regulatory agencies could change dramatically if presidents were permitted to appoint an unlimited number of members of their own party to regulatory agencies."

\textsuperscript{128} Makkai and Braithwaite, "In and Out of the Revolving Door: Making Sense of Regulatory Capture" (1992) 12 J Pub Pol 61.
and notions of regulatory capture, although the data did suggest some limited support for life cycle theories such as that advocated by Bernstein. (In the case of Australian nursing homes regulation, the winding down of the regulatory regime was reflected by the more highly motivated inspectors leaving earlier, while the less highly motivated ones remained.)

In his 1969 study of the politics of the US regulatory process, Kohlmeier considered the available empirical evidence on the relationship between the prospect of industry employment and regulatory behaviour. He came to the view that merit played a substantial part in the process.¹²⁹

There has also been some limited judicial recognition in the United States of the possible existence of regulatory capture. In the case of the Federal Communication Commission Burger J, sitting, (as he then was), as a judge of the US Court of Appeals, District of Columbia Circuit, heard an appeal in 1966 against the renewal of a broadcast licence by the FCC.¹³⁰ In that case the appellant had petitioned to intervene in the regulatory hearing to present evidence and arguments in opposition. The Court expressed doubt that the Commission in that case had validly represented the public interest, including the interests of the appellants, and directed the Commission to re-hear the licence renewal application.¹³¹

¹²⁹. Kohlmeier, The Regulators. Watchdog Agencies and the Public Interest (Harper & Row, New York, 1969), p 74: "The conclusion suggested is that, in general, industry has sought out the more capable people in the regulatory agencies and paid them for their talents. There is almost no evidence that industry has offered high-paying jobs as pay-offs for favourable decisions. Boorish regulators who seek private employment, on the other hand, often don't find it. The problem, then, is not one of ethics so much as how government can retain talented men - at least for the duration of a President's and agency chairman's term of office, until the opposition party installs its own talent in key agency positions."


¹³¹. Ibid pp 1003-1004: "The theory that the Commission can always effectively represent the listener interests in a renewal proceeding without the aid and participation of legitimate listener representatives fulfilling the role of private attorneys general is one of those assumptions we collectively try to work with so long as they are reasonably adequate. When it becomes clear, as it does to us now, that it is no longer a valid assumption which stands up under the realities of actual experience, neither we nor the Commission can continue to rely on it."
While the Chicago\textsuperscript{132} and Virginia\textsuperscript{133} schools of public choice theory have been vocal in their support of theories of regulatory capture, more recent theoretical analysis has shown that most existing theories in this area fail to accord sufficient weight to the many complex variables affecting agency regulation. These include matters such as access to adequate information by regulated firms as well as regulators, the role of public opinion and the complexities of the political process.\textsuperscript{134} There are certainly many contemporary indications in the US economy that influential industry groups are far from capturing their political and regulatory opponents, as the recent travails of the powerful yet beleaguered US tobacco industry demonstrate. This limited explanatory power of theories of regulatory capture has led to the development of more complex models, a topic which will now be addressed.

6.3.5 Self-interest or Budget Maximising Theory

In the United States more complex theories of regulatory agency behaviour have been developed, based on what were thought to be the principal motivating factors influencing such behaviour. The central role played by Congress in federal regulation, including monitoring of agency performance and control over funding through the appropriation process, soon led to attention being focused on the budgetary incentives which might conceivably influence agency behaviour.

In the early 1980s research began to be done on developing models of regulatory behaviour in which Congress was featured as the key motivating factor. This "Congressional dominance" model, as it came to be known, presupposed that regulatory behaviour was directly linked to Congressional influence on individual

132. For representative contributions from the Chicago school see Stigler, \textit{supra} note 107; Peltzman, "Toward a more general theory of regulation" (1976) 19 J L. & Econ 211; Becker, "Public policies, pressure groups and deadweight costs" (1985) 28 J Pub Econ 329.

133. See for example Tullock, "The welfare costs of tariffs, monopoly, and theft" (1967) 5 Western Econ J 224; Tollison, "Rent seeking: A Survey" (1982) 35 Kyklos 575.

134. For a contemporary critique of the shortcomings of the capture theories advanced by public choice theorists such as the Chicago and Virginia schools see Laffont and Tirole, \textit{supra} note 103, pp 475-476.
regulatory agencies. The theory, as expounded by commentators such as Romer and Rosenthal, assumed that regulatory agencies, in common with other bureaucratic organisations, would act in such a way as to maximise their self-interest in terms of access to continued levels of available funding and political favour.

Proponents of the Congressional dominance theory emphasise the importance of the provision of information as a mechanism to enable Congress to maintain its oversight of regulatory agencies. Congress has the ability to rely on information from constituents as well as on information derived from formal and informal monitoring procedures.

While this model may have considerable intuitive appeal in the United States context (though possibly not elsewhere, as will be discussed in chapter 7) it nevertheless suffers from excessive reliance on the role of Congress as the single most significant influence in the American political process. The parts played by the Executive, the Judiciary and other organised bodies, such as particular interest groups, tend to be overlooked. For this reason a more broadly based theory, drawing on analogies from principal/agent theories in economics, has been the focus of more recent efforts. A discussion of such a theory follows.

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136. Romer and Rosenthal, "Modern Political Economy and the Study of Regulation" in Bailey (ed), supra note 83 at p 87: "Changes in regulatory behaviour are in this view traceable to shifts in preferences on relevant committees or changes in committee jurisdiction rather than an independent and Congressionally unsanctioned act of a regulatory agency. The Congressional dominance approach is similar to the economic models in that neither approach provides an active role for the regulatory agency as a distinct component of the regulatory scene. This is in sharp contrast to the myriad descriptive analyses that focus on the internal workings of agencies, their bureaucratic structure, and the politics or personalities of key staff members or commissioners."
6.3.6 Principal and Agent Theories of Regulatory Behaviour

(i) Background and Origins in Economic Theory

The difficulties identified above in developing an adequate theory of regulatory behaviour based on the domination of the US regulatory agencies by the regulated interests, or by Congress, arise in part because such a model does not adequately recognise the more complex interactions which are present in the regulatory process. A more comprehensive theory needs to take account of the role of other interest groups, such as consumers, producers and environmental interest groups, as well as the greater complexity of the political background to the regulatory process, both generally and in terms of specific political influence on the regulatory body.

The need to take account of such complexities in the regulatory scene has been recognised for at least the past twenty years. However the development of a more comprehensive theory has been a difficult process. Initial attempts to formulate a principal/agent hypothesis tended to equate the regulatory agency with the underlying political body, so that the model had much in common with the Congressional dominance theory discussed in the preceding part of this chapter.

The role of interest groups became the subject of analysis at an early stage by commentators such as Becker, in his 1983 study of the subject. Becker argued that politically active interest groups would ensure they were fully informed about the costs and benefits of regulatory policies and would compete for political influence in such a way as to give rise to a set of desirable political policies. Thus, in Becker's view, one interest group might gain at the expense of another, leading to a dynamic equilibrium in which the necessary policy adjustments would reflect the interests and perspectives of a

137. See for example Posner, "Theories of Economic Regulation" (1974) 5 Bell J Econ & Mgt Sc 335; Peltzman, supra note 132. Both authors take the view that Stigler's model of a regulatory process which is attentive only to the interests of industry is inherently unlikely to reflect the complexities of the political process.

138. See for example Peltzman, supra note 132.

number of competing interest groups. Becker's theory does not address in any detail the relationship between the regulatory agency and its political masters, but represents an early attempt to model a theory which recognises the existence of a more complex political environment.

The development of regulatory theories based on the relationship between the regulatory agency and other groups in society has been influenced by the contemporaneous development of principal and agent theories in the sphere of economics. The general background to such theories has been summarised by Rees.\(^{140}\)

It should be borne in mind that the term "contract", as employed in this context by Rees and others, is not intended to be restricted in scope to a formal legal contract but refers more generally to formal and informal interactions involving penalties and rewards, which may not amount to legally binding contracts at all. For example legal rules for the assessment of damages for the inflicting of environmental harm are included, as well as less tangible losses, such as the anticipation of detriment arising from a diminution in the level of government funding.

(ii) Application to Regulatory Behaviour

Some reflection serves to demonstrate that principal and agent theories may be useful in analysing the activities of regulatory agencies. A regulatory agency has some degree of discretion to select a particular regulatory action from a range of alternatives. This action gives rise to a particular outcome (such as lower profits on the part of a utility company) which will depend on a number of factors, including the severity of the action, the ability of the affected party to avoid or mitigate it and whether the action has

\(^{140}\) Rees, "The Theory of Principal and Agent - Part I" (1985) 37 Bulletin Econ Res 3 at 3: "The theory of principal and agent is intended to apply to any situation with the following structure: one individual, called the agent and denoted \(A\), must choose some action \(a\) from some given set of actions \(\{a\}\). The particular outcome \(x\) which results from this choice depends also on which element from some given set of states of the world, \(\{\theta\}\), actually prevails at the relevant time, so that uncertainty is intrinsic to the situation. The outcome \(x\) generates utility to a second individual, the principal, denoted \(P\). A contract is to be defined under which \(P\) makes a payment \(y\) to \(A\). \(A\)'s utility depends both on this payment \(y\) and the value of the action, \(a\). The main purpose of principal-agent theory is to characterize the optimal forms of such contracts under various assumptions about the information \(P\) and \(A\) possess or can acquire and thereby, hopefully, to explain the characteristics of such contracts which are actually observed."
the effect intended by the regulator. The outcome generates utility, in the economic sense, to a second individual, the principal. If the principal is the government which has put the regulatory regime in place, such utility might be the preservation of electoral support or votes from bodies such as interest groups, consumer organisations and so on. These bodies might be expected to view the actions of the regulatory agency in a favourable light and reward the government, as the principal which has appointed the regulatory agent, with increased political support as a consequence.

In turn the principal (represented here by the government) may reward the regulatory agent in various ways, such as through increased budgetary or political support for the continuation of its regulatory activities, possibly coupled with an increase in its powers or prestige. The regulator's utility depends upon the value of the benefit conferred on the regulatory agent by the government principal, which in turn can be traced back to the value of the regulatory action $a$, which was taken by the regulatory agent originally.

It can therefore be seen that, at least on a prima facie basis, principal and agent theories may provide an appropriate explanatory model for regulatory actions. Furthermore such theories can also be applied (admittedly with greater difficulty) to a situation where the same agent serves more than one principal. Thus, in the US context, a regulatory agency may be responsible both to the Executive and Legislative arms of government, represented by the President and Congress. To widen the perspective beyond the political arena, a regulatory agency may also have responsibilities towards particular interest groups, such as consumer associations and environmental interest groups.

Obviously, a principal-agent theory which seeks to take account of the interests of more than one principal can quickly encounter complex theoretical difficulties. This is especially the case where the interests of the various principals either do not coincide or are in direct conflict. If the principal is a political actor, for example, there is no guarantee that the interests of the various arms of the political process will be in agreement. The discussion earlier in this chapter about the conflicts between the President and Congress in various areas of the regulatory process, particularly that of the oversight of regulations made by agencies, makes this amply clear. Similarly the interests of government and particular interest groups may not coincide, depending on
assessments of the political power of such groups when compared with industry interests.

Even among interest groups themselves policy goals can conceivably differ. An environmental interest group may seek to achieve a greater level of environmental protection through regulatory action, even at the expense of higher consumer price levels, an outcome which might not necessarily find favour with consumer organisations. Similarly the interests of organised labour in increasing wage and salary levels may lead to higher industry cost structures and therefore to higher price levels, an outcome which again may not find favour with consumer groups. If such actions by organised labour diminish available funds which would otherwise be used to institute environmental protection programmes then another obvious source of conflict with environmental interest groups can arise. As the discussion in chapter 5 has shown, unusual alliances may result. Employee groups and regulated firms may perceive an identity of interest in the face of stringent rate setting policies by a regulatory agency, which may be perceived as raising the threat of both job losses and reduced profits.\(^{141}\)

The challenge confronting the designers of principal/agent based models of regulatory behaviour is to devise a model which adequately takes account of the potential conflict which may ensue where the agent is responsible to more than one principal. The difficulty of designing such a model in the context of existing structures is illustrated by the well known problem of accommodating polycentric disputes within traditional judicial models of adjudication,\(^{142}\) and the difficulty is no less pronounced in the context of regulation by administrative agencies, as Romer and Rosenthal have noted.\(^{143}\)

\(^{141}\) See the discussion in part 5.2.2(ii) of chapter 5.

\(^{142}\) See for example Weiler, "Two Models of Judicial Decision-making" (1968) 46 Can Bar Rev 406; Fuller, "The Forms and Limits of Adjudication" (1978) 92 Harv LR 353.

\(^{143}\) Romer and Rosenthal, *supra* note 136 at p 88: "The principal-agent analogy has considerable intuitive appeal, though its formal application (as opposed to invocation) in the context of regulation faces serious challenges. Probably the greatest difficulty with making the argument more formal, and structuring it in such a way that it yields robust *a priori* hypotheses, is that it requires a careful specification of the principal's preferences. But if individual legislators face multiple constituencies, even characterising individual *V* [the symbol which the authors use to refer to legislator preference levels] may be difficult. Characterizing the preferences of Congress is subject to even more severe problems. Thus the problem is really one where there
(iii) Some Areas of Difficulty

The above discussion should not be permitted to obscure the fact that there is a considerable range of complexity to be found in differing levels of principal-agent relationships. The relationship, for example, between a homeowner appointing an estate agent to sell his or her house or a patient acting as principal in appointing a doctor as his or her agent to perform medical services on the patient's behalf involve quite different considerations from a government appointing a regulatory agency to regulate a particular industry in accordance with what may be quite complex statutory criteria.

The fundamental bases of economic theory may also start to break down when applied to more complex principal/agent situations. Thus the focus of economic theory on the maximising of individual utility may readily explain the desire of the homeowner to ensure the estate agent secures the best price available for the house. The estate agent, operating on a commission basis, is motivated to achieve the same end which the principal desires. However the situation may be much more complicated in the public arena. Economic theory might tend to presuppose that a regulatory agency will be inclined to act so as to court political favour and maximise its prestige and budgetary entitlements. Similarly economic theory would tend to predict that political interests will endeavour to persuade the regulator, through either direct or indirect measures, to adopt a regulatory policy which maximises political benefits, such as the promotion of high levels of electoral support.

However, political relationships rarely fulfill the neat criteria of economic theory. Regulatory agencies may be motivated by a variety of policy criteria. These might include the desire of a professional regulator to demonstrate independence from the political process or to adopt regulatory policies which are consistent with the regulator's professional leanings (particularly if the regulator is an economist or lawyer) rather than policies which are simply designed to appease the appointing authority. There may be a strong corporate ethic or esprit de corps in the regulatory agency. In some cases the
regulator may simply be a strong minded individual or group of individuals who are not unduly concerned, at least within reason, at arousing political disfavour.

The motives of the political body may be similarly complex. It is not unknown (either in the United States or the United Kingdom) for politicians to allow regulatory bodies to grapple with political hot potatoes and then to allow the regulator to receive any backlash arising from unpopular decisions, relying on the independent status of the regulator as an excuse for lack of political interference in the decision. In this way politicians may seek to have the best of both worlds - they will allow a stringent regulatory regime to be imposed while at the same time avoiding responsibility for any unpopular decisions which may be taken by the regulator in the course of the regulatory process.

The link between government funding of regulatory agencies and an implicit requirement that such agencies "toe the line" may also be much less direct than theorists would suppose, given that budgetary functions are often separate from direct political interaction between the regulator and the political power. However a regulator who was a consistently outspoken critic of core government policies may well find that budgetary controls were not the only weapon in the Government's armoury. Direct or indirect pressure on such a regulator to change his or her views or resign might lead to an equally cogent result.

(iv) Application to the US Regulatory Situation

In the United States context, imponderables which flow from policy conflicts between the President and Congress have been recognised as a complicating factor in applying principal/agent analysis to regulatory agencies. Such conflict can arise in various areas, two prominent examples being political oversight in relation to the rulemaking process and controls over appointment of regulatory personnel. An agency seeking to maximise its political standing also needs to take careful account of the different perspectives among the political actors.

Attempts to model these more complex interactions in the context of the American system have encountered difficulties in determining what weight to assign to each of
these various external influences. Spiller has postulated a three-tier model involving Congress, industry groups and the regulator and has endeavoured to predict regulatory behaviour by applying the mathematics of game theory to such a structure. While his model represents an advance on previous work in the area it does not take into account divisions of approach at the political level or the role of interest groups, all of which are factors which serve to exert influence on regulatory bodies.

Shapiro has recently surveyed the state of principal/agent theory when applied to the US regulatory scene. He has noted the conflict between the President and Congress in relation to aspects of regulatory policy such as monitoring and oversight procedures and the use of veto powers to control regulatory legislation. Shapiro also discerned a recent tendency towards the use of more detailed regulatory legislation (reflected in recent amendments to the Clean Air Act 1990 by way of example) and has observed that such an approach may be counter-productive in regulatory terms.

Shapiro noted that continuing policy disagreements between Congress and the White House over the form and content of regulatory policy were likely to continue in the future, so that tactical manoeuvring between these two arms of government in areas such as the oversight of regulatory activity would persist. Such a situation would be likely to enhance the difficulties inherent in deriving a suitable model of regulatory behaviour based on principal/agent foundations.

Nevertheless, it is likely that in the medium term, theories based on principal/agent considerations will be found to have the greatest explanatory power in the regulatory area. If a model can be devised which takes account of conflicting objectives between multiple principals, while ascribing differing levels of importance to the factors which motivate agency behaviour, then such a model is likely to come closest to replicating


145. Shapiro, supra note 102.

146. Ibid p 26: "From a democratic perspective, it is difficult to carp about Congress making regulatory policy, but such micromanagement has a downside which is to deny EPA the flexibility it needs to implement complicated regulatory regimes. When EPA is stymied by legislative prescription, Congress often responds with the wrong medicine by passing still more detailed legislation."
conditions in the real world. Such a theory is not greatly removed from the concept of a stakeholder approach to economic regulation which was described in chapter 5.\footnote{See the discussion in part 5.2.2 of chapter 5.}

The various stakeholders interact with government, through the medium of the regulatory agency, and seek to have the regulatory process reflect their particular perspectives.

Before leaving this subject, some mention should be made of two other variations on the above theories which are worthy of note. One possible resolution of any problems of industry influence on regulatory agencies may involve empowering public interest groups through formal tripartite relationships. These would involve conferring formal status on external groups as participants in the regulatory process, so reducing the potential influence of industry groups on the regulatory agency. Such a suggestion has been advanced by Ayres and Braithwaite.\footnote{Ayres and Braithwaite, "Tri-Partism: Regulatory Capture and Empowerment" (1991) 16 Law and Social Inquiry 435.} This approach would entail granting some kind of recognised status to such groups, probably through legislation. In the United States such an outcome has been achieved by consultation requirements imposed in the course of the rulemaking process, combined with mechanisms to facilitate interest group participation, a matter which will be discussed later in this chapter and again in chapter 10.

In the US context some research has also been carried out on the influence exerted by internal agency structures on regulatory agency behaviour. The main thrust of this work has been in relation to the Federal Trade Commission, where the interaction in antitrust cases between the agency's Bureau of Competition (largely comprised of lawyers) and its Bureau of Economics (staffed mainly by economists) has been the subject of study by Katzmann and others.\footnote{Katzmann, \textit{Regulatory Bureaucracy} (MIT Press, Cambridge, Mass, 1980).} Most previous studies had assumed that agencies are uniform or homogenous in their composition and approach to regulatory issues, an assumption which Katzmann's study has shown is demonstrably not the case in the United States context. (It may however be more accurate in the context of
United Kingdom utility regulation, where an individual regulator is responsible for regulatory policy in relation to a particular utility in the final analysis.)

West has drawn attention to the need to analyse the internal composition of agencies in the US context and has suggested that informal organisational culture may be equally as important a factor in setting regulatory policy as an agency's formal operating procedures.\textsuperscript{150} Such an approach is clearly justifiable as the perspective which different professions may bring to bear on regulatory problems may be quite different and complementary.\textsuperscript{151} Regulatory bodies in both the United States and Britain now rely on a wide range of professional expertise in reaching their decisions.

6.4 Administrative Rule Making - The United States Experience

6.4.1 Introduction and Background

(i) The Importance of the Concept of Due Process

The US system of administrative rule making and accompanying judicial controls over the rule making process form a central part of US administrative law and the process of economic regulation in America. However, the evolution of rule making procedures within the framework of APA requirements cannot properly be understood without some appreciation of the central importance of due process requirements in American constitutional and administrative law.\textsuperscript{152} The origins of the due process concept can be traced back to English decisions, pre-dating the American constitution, which

\textsuperscript{150} West, "The Growth of Internal Conflict in Administrative Regulation" (1988) 48 Pub Admin Rev 773. See also Eisner, "Bureaucratic Professionalization and the Limits of the Political Control Thesis: The Case of the Federal Trade Commission" (1993) 6 Governance 127, who argues that internal organisational factors in agencies, illustrated by the predominant influence of economists at the FTC, is a more important factor in explaining agency policies than external influences emanating from Congress or the White House.

\textsuperscript{151} Opinions as to the respective characteristics of different professional groups are of course not always flattering. As one cynic remarked, if all the economists in the world were laid end to end they would never reach a conclusion. This is matched by the only slightly less apocryphal tale of the lawyer who, when asked the length of a piece of string, retorted by asking "How long do you want it to be?"

\textsuperscript{152} For a useful discussion of the constitutional right of due process as it is reflected in judicial control of administrative action in the United States see Schwartz, \textit{supra} note 38, chapter 5; Mashaw, \textit{Due Process in the Administrative State} (Yale UP, New Haven, 1985).
established the right to a hearing on the part of any party in personal or financial jeopardy. The US constitutional requirement of due process came to be reflected administratively in a preference for adversarial procedures embodying the attributes of court hearings, as was noted in one US case, decided in 1970.

As American commentators have noted, due process requirements and their legislative embodiments in the US APA have come to mean that administrative procedure now shares many of the attributes of courtroom procedure. Professor Schwartz, for example, includes among the rights which due process requires an administrative agency to provide: the right to receive adequate notice of a regulatory hearing, the right to present oral and documentary evidence and argument, the right to rebut adverse evidence through cross-examination and the right to appear with counsel. He also includes the right to have the agency's decision based solely upon evidence contained in the record of the hearing, the right to have a complete record of that evidence and the right to reasons supporting the agency's decision. The situation in the United States, under the pervasive influence of due process requirements, derived from the Constitution, statute and common law, is therefore much less flexible than the application of the elements of natural justice to administrative decision-making in the United Kingdom, where matters such as the nature of the decision and the statutory context remain important factors for a court to take into account.

153. As the court of King's Bench noted in R v University of Cambridge (1723) 1 Str 557, 567; 93 ER 698, 704: "Even God himself did not pass sentence upon Adam before he was called upon to make his defence. Adam (says God), where art thou? Hast thou not eaten of the tree, whereof I commanded thee that thou shouldst not eat?" For a discussion of the evolution of the concept of due process in English and American law see Galligan, Due Process and Fair Procedures: A Study of Administrative Procedures (Clarendon Press, Oxford, 1996), chapters 5 and 6.

154. Mortensen v Board of Trustees 473 P 2d 866 (1970) (Hawaii Sup Ct): "...where an ascertainment of the truth is more likely through the use of a trial-type hearing, it should be used at some point in the administrative process. Real expertise will not be hindered but strengthened by its exposure to the fire of cross-examination, rebuttal evidence, and argument. An examination or inspection by an expert is simply no substitute for a trial-type hearing except, perhaps, in certain limited circumstances."


156. See Craig, Administrative Law (Sweet & Maxwell, London, 3rd ed, 1994) chapters 8 and 9. As Craig notes at p 296: "In deciding upon the application of natural justice or fairness the court will, as noted above, balance between, on the one hand, the nature of the individual's interest, and on the other, the likely benefit to be gained from an increase in procedural rights and the costs to the administration of having to comply with such process rights."
The relationship between the 'notice and comment' rulemaking procedure and concepts of fairness and due process is also a close one. The use of these procedures serves to alleviate any lack of democratic accountability associated with agency rule making, as several academic commentators have pointed out.\textsuperscript{157} The US courts have also stressed that the notice and comment procedure is designed to ensure fairness to all parties affected by the proposed rule.\textsuperscript{158} In this way the APA procedures have served to address the objection that the delegation of powers of a legislative nature to the administrative agencies is undemocratic in nature.

(ii) Historical Use of Rule Making Powers in the United States

Long before the rise of the independent regulatory agency, the use of administrative rules to implement general statutory provisions was a relatively common procedure under US law, dating back to the time of the First Congress.\textsuperscript{159} Until the present century administrative rule making powers were generally restricted to matters of public business such as revenue affairs, postal administration and public health. The greatly expanded role of the administrative process during the twentieth century led inevitably to a broadening of the range of activities which became subject to the rule making function. This trend gained considerable impetus after the passing of the federal Administrative Procedure Act in 1946.

\textsuperscript{157} See Asimow, \textit{Paper prepared for the Administrative Conference of the United States, Interim-Final Rules No. 8} (ACUS, Washington DC, 1995), at p 5: "A rulemaking agency is making new law without direct accountability to the voters; notice and comment procedure helps alleviate the undemocratic character of this process." See also Kannan, "The Logical Outgrowth Doctrine in Rulemaking" (1996) 48 Admin LR 213 at 219: "The notice and comment procedure is designed to open the agencies' legislative activities to the public. It was the first ray in the 'government in the sunshine' philosophy. However, it does more than merely create a visitors gallery and convert rulemaking into a spectator sport. It empowers the public to question the proposed regulation, and the data and assumptions on which it is based, before it becomes effective."

\textsuperscript{158} See for example \textit{National Association of Home Health Agencies v Schweiker} 690 F 2d 932 at 949 (DC Cir. 1982); \textit{Small Refiner Lead Phase-Down Task Force v EPA} 705 F 2d 506 at 547 (DC Cir. 1983); \textit{Florida Power & Light Co v United States} 846 F 2d 765 at 771 (DC Cir. 1988).

\textsuperscript{159} As early as 1790 the First Congress had allowed the President to issue rules on the subject of trading with Indian tribes. (See 1 Stat. 137 (1790)). For a brief summary of the historical development of US rule making see Cooper, \textit{Administrative Agencies and the Courts} (Michigan Legal Studies, University of Michigan Law School, Ann Arbor, Michigan, 1951), chapter 13.
It is not the purpose of the present chapter to provide an exhaustive account of all aspects of the process of American administrative rule making. Such a task has been exhaustively undertaken in the leading works on the subject. However, it is necessary here to detail enough of the process to allow the reader to grasp the essential elements of the US system and also to appreciate some of its acknowledged deficiencies and the reasons for these. This analysis will then be applied in the following chapter to the United Kingdom context in order to assess the extent to which administrative rule making procedures might be applicable to the UK situation.

6.4.2 US Rule Making Under the Administrative Procedure Act

(i) The Distinction Between Rule Making and Adjudication

In this part of the chapter the requirements of the Administrative Procedure Act (APA) are described in relation to the form and content of administrative rules. For ease of reference some relevant excerpts from the APA are included in Appendix I to this chapter.

The distinction made in the APA between rule making and adjudication seems clear in principle but on closer analysis the dividing line is harder to draw. In chapter 4 some of the difficulties which are inherent in attempting to distinguish legislative from judicial and administrative functions were discussed. These differences were summarised by Justice Holmes in a decision given in 1908, well before the passing of the APA.


161. See the discussion in part 4.8.4 of chapter 4.

162. Prentis v Atlantic Coast Line Co 211 US 210 (1908) at 226: "A judicial inquiry investigates, declares and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. That is its purpose and end. Legislation on the other hand looks to the future and changes existing conditions by making a new rule to be applied thereafter to all or some part of those subject to its power."
It can be seen from the above passage and from the APA definitions in § 551(4), (6) and (7) that a rule operates in respect of future conduct whereas a judicial decision is based on a past or present factual situation. Other judges have emphasised breadth of application as being the most significant element distinguishing legislative from judicial functions. Whereas rule making is intended to produce requirements of general application an adjudication is intended to apply specifically to the individuals or situations which are the subject of particular dispute.\textsuperscript{163} While these tests are adequate in most cases they do not fit every situation. Some areas of difficulty arise in the case of injunctive orders (which are adjudicative in nature but have some of the attributes of rule making) and rate setting processes (which, being of general application, are legislative in nature but result from a judicial process).\textsuperscript{164}

(ii) The Ascendancy of the Rule Making Function

Shapiro, writing in 1965, evaluated the comparative merits of rule making and adjudication and noted that the use of these techniques was fairly evenly matched at that time. If anything there appeared at that time to be a reluctance on the part of agencies to make full use of their rule making powers.\textsuperscript{165} Indeed, as Shapiro noted, some administrative agencies such as the National Labour Relations Board and the Federal Trade Commission placed more emphasis on their adjudicative functions than on their rule making role. This situation changed radically over the succeeding thirty years, to the extent that Professor Schwartz, writing in 1991, felt able to observe that the rule making function was now in the ascendancy.\textsuperscript{166}

\begin{itemize}
\item \textsuperscript{163} See for example \textit{American Airlines v CAB} 359 F 2d 624, 636 (DC Cir. 1966); 385 US 843 (1966); \textit{Hardee's Food Sys. v Department of Transportation} 434 A 2d 1209, 1212 (Penn Sup Ct, 1981).
\item \textsuperscript{164} For a discussion of these matters see Schwartz, supra note 38, pp 163-167.
\item \textsuperscript{165} See Shapiro, "The Choice of Rule Making or Adjudication in the Development of Administrative Policy" (1965) 78 Harv LR 921.
\item \textsuperscript{166} Schwartz, supra note 38, p 167: "Rule making power is an outstanding feature of the modern administrative agency. As Justice Scalia tells us, 'Agency rule making powers are the rule rather than, as they once were, the exception.' During the past two decades, rule making has been increasingly substituted for adjudication as a regulatory technique, with the support and encouragement of the courts. By now there is a significant body of case law that favours the use
\end{itemize}
This rise in the importance of the rule making function has been accompanied by increasingly higher levels of judicial scrutiny of the rule making process, aimed not only at ensuring agency compliance with the APA requirements (especially those concerning public notification and consultation) but also directed, in varying degrees, to the substantive reasonableness of the rules themselves. This is not to say that agency adjudications, on the other hand, are immune from challenge. Indeed, most agencies have put in place internal appellate structures under which agency decisions can be reviewed by a board or panel and due process requirements must be observed in relation to the hearing.\(^{167}\) There have, however, been forceful criticisms that the federal regulatory process has spiralled out of control and these will be examined in more detail later in this chapter.

(iii) Consultative Requirements in the Rule Making Process

The rationale for consultative requirements was set out, prior to the passing of the APA, in a 1941 Report by the Attorney General's Committee on Administrative Procedure.\(^{168}\) In its report the Committee placed emphasis on the importance of allowing all persons affected by the actions of administrative agencies to be able to present their views on the matters under consideration. It considered that public participation in the rule making process was "essential in order to permit administrative agencies to inform themselves and to afford adequate safeguards to private interests."\(^{169}\)

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167. For a discussion of these mechanisms see Weaver, "Appellate Review in Executive Departments and Agencies" (1996) 48 Admin LR 251.


In this way, the agency would be able to obtain "the information, facts, and probabilities which are necessary to fair and intelligent action." From this underlying policy it can be seen that the philosophy of the APA was to encourage public involvement in the rule making process before the rules in question were finalised, as a means by which administrative action could be made democratically accountable. Bonfield has noted the democratic significance of these procedures.

The general requirement imposed by the APA of publication of delegated legislation represents a considerable advance on the corresponding position in the United Kingdom in relation to the publication of statutory instruments. This aspect will be discussed further in chapter 8.

It is important to appreciate, in this context, the distinction which the APA draws between rules which require trial-type procedures for their implementation, as opposed to rules which can be adopted following the simpler "notice and comment" procedure. Under §553(3)(c) rules which can be adopted under the latter procedure are made after interested persons have been given "an opportunity to participate in the rulemaking through submission of written data, views, or arguments with or without opportunity for oral presentation."

Drawing a distinction between legislative and non-legislative rules may be more difficult in practice, as commentators such as Asimow have noted. In Asimow's

170. Ibid 102.

171. Bonfield, supra note 168, pp 541-542: "Parties affected by administrative rules have a distinct personal interest in how they are made. An adequate opportunity to present relevant information to appropriate officials is one of the most important tools with which individuals can defend themselves against an exercise of rule making power that may be detrimental to their interests. Political realities may make legislative modification of unwise regulations hopeless; and the breadth of agency discretion may make judicial assaults unsuccessful. In cases of this sort, an opportunity for affected parties to communicate their views on proposed rules to the appropriate officials may be the only meaningful chance those parties will have to protect their interests against rules they consider unwise."

172. Schwartz contrasts the relative simplicity of the APA procedures with the more limited UK requirements relating to the publication of delegated legislation, such as those contained in the Statutory Instruments Act 1946, in his comparison between the role of the Executive in the two jurisdictions. See Schwartz, Law and the Executive in Britain: A Comparative Study (Cambridge UP, Cambridge, 1949), pp 132-140.

173. Asimow, "Nonlegislative Rulemaking and Regulatory Reform" (1985) 35 Duke LJ 381 at 381-382: "Under the federal APA, an agency has discretion to adopt nonlegislative rules without any pre- or post- adoption procedure, other than a requirement that it publish rules of general
view the imposition of more stringent notice and comment requirements in agencies seeking to adopt more legislative rules would discourage agencies from undertaking rule-making activities. This in turn would be detrimental to the public interest.\textsuperscript{174}

The role of the courts in facilitating and encouraging participation by representative interest groups has been perceived by some commentators as marking the way forward for US administrative law. In his well-known article on the reformation of American administrative law, published in 1975, Professor Stewart envisaged an interest representation model as being the defining feature of an evolving model of US administrative law.\textsuperscript{175} It is, however, debatable the extent to which US administrative law has moved in the direction foreseen by Stewart in the intervening 20 years. However, there is no doubt that the APA, both in its terms and in its judicial interpretation, continues to play a significant part in encouraging public participation in the rule-making process.

(iv) Consultation and Participation Requirements in Practice

To return to the mechanics of the process, after the agency has considered the material presented to it the rule can then be adopted. In cases where the individual statute conferring the rule making power on the particular agency requires rules to be made "on the record after opportunity for an agency hearing", the more detailed trial-type procedures prescribed by §§556-557 apply. These sections impose complex hearing requirements, including procedural requirements for hearings, entitlement to submit

\textsuperscript{174} As Asimow puts it, \textit{ibid}, p 426: "... to open all nonlegislative rules to advance public participation would have a devastatingly negative effect on the administrative process."

\textsuperscript{175} Stewart, "The Reformation of American Administrative Law" (1975) 88 Harv LR 1667 at 1813: "... stemming from the expansion of government influence over personal welfare and the contemporary perception that agencies enjoy discretion and that they have misused it to favor organized and regulated interests, judges have expanded formal participation rights in a fashion that points toward the development of an interest representation theory of administrative law to replace the traditional model. Whether a fully-articulated model of interest representation will emerge from these efforts or whether interest representation is simply an interim stage in the emergence of some totally new conception of the relation between administrative institutions, legal controls, private groups, and social and individual values, is as yet unclear."
rebuttal evidence and conduct cross examination and an obligation on the part of the
hearing authority to assemble a record, including a transcript of the testimony and
exhibits presented.

During the 1970s the US courts tended to engraft additional procedural obligations onto
the notice and comment procedures provided under the APA. This process was
effectively halted by the US Supreme Court in 1978 in the well known case of *Vermont
Yankee*,\(^{176}\) which concerned the availability of judicial review in relation to procedures
for the licensing of nuclear power plants by the Atomic Energy Commission. Justice
Rehnquist, delivering the unanimous opinion of the seven member court, affirmed, in a
well known passage, the importance of upholding reasonable agency procedures.\(^{177}\)
This important decision imposed clear limits on hybrid rule making processes
("hybridisation") and represented the beginnings of a retreat from the strong judicial
interventionism of the 1970s into the regulatory process.\(^{178}\)

The APA allows for exceptions from the notice and comment requirements themselves
under certain defined circumstances. Under §553(3)(B) an exception arises where the
"agency for good cause finds... that notice and public procedure thereon are
impracticable, unnecessary or contrary to the public interest." Other exceptions are
made where the rules in question are interpretative in nature, amount to general
statements of policy or are rules of agency organisation, procedure or practice.

The boundaries between interpretative and legislative rules have been described in one
US case as being "enshrouded in considerable smog".\(^{179}\) The ACUS has endeavoured


\(^{177}\) *Ibid* 543: "Absent constitutional constraints or extremely compelling circumstances the
administrative agencies should be free to fashion their own rules of procedure and to pursue
methods of enquiry capable of permitting them to discharge their multitudinous duties."

\(^{178}\) For discussions of the significance of the *Vermont Yankee* decision see Gulas, "The American
Administrative State: The New Leviathan" (1991) 28 Duq LR 489, 500-501; Breyer and
Stewart, *supra* note 3, pp 582-592; Lewis, "Privatisation, De-Regulation and Constitutionality:
Some Anglo-American Comparisons" (1983) 34 NILQ 207, 215-217. For a summary of the
position prior to the *Vermont Yankee* case see Williams, "'Hybrid Rulemaking' Under the
Administrative Procedure Act: A Legal and Empirical Analysis" (1975) 42 U Chic LR 401.

\(^{179}\) See *Noel v Chapman* 508 F 2d 1023 at 1030 (2nd Cir. 1975).
to clarify the issue in two recent policy statements\textsuperscript{180} and there has been considerable academic interest in the subject.\textsuperscript{181} While the agencies may be tempted to try to avoid the complexities of the notice and comment rulemaking procedures by relying on the APA exemptions they run the risk of having the rules which are adopted overturned in judicial review proceedings if they cannot be shown to the satisfaction of the reviewing court to fall within the exemptions provided.\textsuperscript{182}

The APA exceptions have been applied in several recent US cases involving regulatory agencies. In a 1992 case the FCC had issued a notice in which it asserted that its existing rules did not require the separating of wholesale and retail operations on the part of providers of cellular telephone services.\textsuperscript{183} The DC Circuit Court of Appeals found that the notice and comment procedures did not apply in those circumstances as the notice was interpretative in nature, in that it served to resolve an ambiguity in the existing rules.

\textsuperscript{180} See Administrative Conference of the United States, Recommendation 92-1. The Procedural and Practice Rule Exemption from the APA Notice-and-Comment Rulemaking Requirements (ACUS, Washington DC, June 18, 1992) at p 2: "The Conference therefore recommends, as a guide to agencies in determining when a rule is procedural, that agencies should establish first that the rule relates to an agency's internal operations or methods of interacting with the public and second that the rule has no substantive impact because it neither significantly affects conduct, activity or a substantive interest that is the subject of agency regulation, nor affects the standards for eligibility for government programs. Only if the proposed rule meets both parts of this test, should it be considered as being within the exemption from notice-and-comment requirements as a rule of practice or procedure." See also Administrative Conference of the United States, Recommendation 92-2. Agency Policy Statements (ACUS, Washington DC, June 18, 1992) at p 1: "The Conference is concerned, however, about situations where agencies issue policy statements which they treat or which are reasonably regarded by the public as binding and dispositive of the issues they address. The issuance of such binding pronouncements as policy statements does not offer the opportunity for public comment which is normally afforded during the notice-and-comment legislative rulemaking process for rules which have the force of law. Courts have frequently overruled agency reliance on policy statements as binding on affected persons."


\textsuperscript{182} See for example United States Tel. Ass'n v FCC 28 F 3d 1232 at 1235 (DC Cir. 1994), in which the DC Circuit Court of Appeals criticised an attempt by the FCC to classify a rule as an exempt policy statement as an "agency hat trick" designed to circumvent the APA notice and comment procedures.
The Ninth Circuit Court of Appeals reached a similar conclusion in a case also decided in 1992, in which a rule issued by the FERC clarifying the commencement date of a statutory requirement under the Clean Water Act was held to be interpretative, not legislative, even though it involved a statutory requirement under the relevant legislation. It seems that the issue is one of fact and degree. The effect of the new rule is of central importance, as the District of Columbia Circuit Court of Appeal put it in another recent case.

There is no doubt that the enforced participation requirements in the APA have exercised a significant effect on the American administrative process, not only in relation to agency actions, but also in terms of the political and social effects engendered through the mobilisation of organised interest groups in American society. Kerwin has noted the emergence of the "participation revolution" during the 1960s and 1970s, encouraged by Congressional legislation such as the Freedom of Information Act, the Government in the Sunshine Act and the Federal Advisory Committee Act, all of which were passed during this period.

(v) The Freedom of Information Act and Related Legislation

It is appropriate at this point to mention some aspects of these three statutes as they have exerted a significant influence on the shape of US economic regulation. Perhaps the most significant of these pieces of legislation, especially compared with the UK situation, has been the US Freedom of Information Act of 1966. This Act, which

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185. *National Family Planning and Reproductive Health Association Inc v Sullivan* 979 F 2d 227, 241 (DC Cir. 1992): "... when an agency adopts a new construction of an old rule that repudiates or substantially amends the effect of the previous rule on the public, ... the agency must adhere to the notice and comment requirements of §553 of the APA."

186. For a survey of the evolution of participation requirements in the American administrative process see Kerwin, *supra* note 38, chapter 5.

was the forerunner of a number of other Commonwealth examples, sadly not yet emulated in the United Kingdom, represented a sea change in attitude to the release of official documents and information. In basic terms, the Act required agencies to publish specified information in the Federal Register, make certain information available for public inspection and copying and also make specified information available on request to members of the public. Further legislation has also been passed by the individual state legislatures.

The information required to be published in the Federal Register included details of agency organisation, the places where application for information might be made, a general statement of the agency's procedures, all internal rules of agency procedure, statements of general policy and substantive rules adopted by the agency, and all amendments made from time to time to documents in each of these categories. Items which the Act required be made available for inspection and copying included adjudicative orders and opinions, statements of policy and interpretation not already published in the Federal Register, staff manuals and internal instructions to staff. All other "agency records" (a term which has been widely defined to include basically all documents created by or obtained by an agency in the course of its activities\(^\text{188}\)) must be promptly made available upon receipt of a request that contains a reasonable description of the document sought and follows the agency's published procedures for release of information, including payment of any prescribed fee.

Disclosure is subject to certain exceptions, including exemptions relating to internal personnel rules and practices of an agency, interagency documents which would normally be privileged from civil discovery, personnel and medical files subject to personal privacy interests and other material compiled for confidential law enforcement purposes (eg the identity of informers or undercover police officers) or which is subject to national security considerations. In the regulatory context an important exception relates to commercial or financial information which has been obtained in circumstances of confidentiality. The US case law indicates that this exception will apply where disclosure of the information would be likely to reduce the ability of the

\(^{188}\) For judicial confirmation of the breadth of this definition see Department of Justice v Tax Analysts 492 US 136 (1989); Wolfe v HHS 711 F 2d 1077 (DC Cir. 1983)
government to obtain similar information in other cases or would cause substantial harm to the person or firm submitting the information, in terms of their ability to retain a competitive market position. More recent cases have held that the possibility of more general adverse consequences to government programmes might also be a ground for withholding information under this head.

The Administrative Conference of the United States made a recommendation in 1982 that systematic procedures be established by agencies to cover release of information in terms of this exemption. An Executive Order issued in 1987 obliged agencies to follow the recommendations of the Conference in this area.

The substantial impact of the FOIA on then existing US administrative and regulatory practice should not be underestimated, a fact which was recognised by the US Attorney General at the time the Act was passed. The strict requirements of the FOIA have

189. See National Parks and Conservation Association v Morton 498 F 2d 765 (DC Cir. 1974).

190. See for example 9 to 5 Organization for Women Office Workers v Board of Governors of the Federal Reserve System 721 F 2d 1 (1st Cir. 1983); Critical Mass Energy Project v NRC 830 F 2d 278 (DC Cir. 1987).


192. See Executive Order 12,600, Predisclosure Notification Procedures for Confidential Commercial Information 3 CFR 235 (1988). This order, issued on 23 June 1987, is set out in the Federal Administrative Procedure Source Book, supra note 187, pp 653-666. Section 2 of the Order defines "confidential commercial information" as meaning "records provided to the government by a submitter that arguably contain material exempt from release under Exemption 4 of the Freedom of Information Act, 5 USC 552 (b)(4), because disclosure could reasonably be expected to cause substantial competitive harm".

193. See Attorney General's Memorandum on the Public Information Section of the Administrative Procedure Act - A Memorandum for the Executive Departments and Agencies Concerning Section 3 of the Administrative Procedure Act as revised effective July 4, 1967 (US Department of Justice Publication, June 1967) at p III: "Public Law 89-487 is the product of prolonged deliberation. It reflects the balancing of competing principles within our democratic order. It is not a mere re-codification of existing practices in records management and in providing individual access to Government documents. Nor is it a mere statement of objectives or an expression of intent. Rather this statute imposes on the executive branch an affirmative obligation to adopt new standards and practices for publication and availability of information. It leaves no doubt that disclosure is a transcendent goal, yielding only to such compelling considerations as those provided for in the exemptions of the act." This message was reinforced by Attorney General Ramsey Clark in the press release accompanying the release of his memorandum, in which it was noted: "Clark's introductory message for the information guidelines was more strongly worded against policies of secrecy than was an earlier draft of the guidelines obtained by The Washington Post last month." (See article in The Washington Post, June 18, 1967: "Clark Tells Agencies to Obey Information Act.")
undeniably helped to promote better agency decision making, in that agency officials are well aware that the supporting evidence and documentation on which regulatory decisions have been based may need to be made available for public scrutiny if requested. Empirical work carried out with US regulatory agencies as part of the research for this thesis, and which will be described in chapter 10, indicated that agency officials are continually mindful of the fact that their internal memoranda and documents may be the subject of an FOIA request, which in turn has led to greater care in the drafting and scrutiny of such documentation. By way of contrast, in UK regulatory practice, where such a statutory framework does not apply, the corresponding incentives are absent. Thus, to take one recent example, the Gas Regulator has recently been able to withhold production of a consultant's report prepared for the regulator on the structure of TransCo, despite a specific request for a copy made to her by British Gas.¹⁹⁴

The differences between US and UK regulatory practice in this area were brought home to the writer in the course of researching this thesis in a number of ways. While requests to US regulatory agencies for relevant documentation often resulted in an embarrassment of riches (at not inconsiderable expense to the US taxpayer in terms of air mail postage), the opposite was unfortunately frequently the case with other UK agencies and government departments, with some notable exceptions (including OFTEL and the Rail Regulator). The usual reaction of UK agencies and departments to letters requesting specific information was frequently no response at all, or occasionally a telephone call promising a subsequent response which then never eventuated.¹⁹⁵

¹⁹⁴. See article in The Times, 11 July 1996: "Disclosure of tax price reports urged", reporting on the refusal of the gas regulator, Clare Spottiswoode, to disclose to British Gas the contents of two consultants' reports which OFGAS had obtained on TransCo's cost structure for the purpose of the regulator's gas pricing review. For a theoretical discussion of the extent to which commercially sensitive information ought to be protected from disclosure under freedom of information legislation see Baxter, "Public Access to Business Information held by Government" [1997] JBL 199.

¹⁹⁵. The writer has accumulated abundant empirical evidence in the course of his thesis research that a self regulatory approach to more open government seems doomed to failure, having failed to persuade the staff of several government departments to allow him to see copies of submissions made by various parties on UK competition and regulatory issues and proposed new competition legislation. Such documents are publicly available as of right in those jurisdictions such as the United States which have freedom of information legislation in place. There are some signs that this attitude may be about to change, with the present Public Services Minister, Dr David Clark, having recently been studying Freedom of Information legislation in other Commonwealth jurisdictions such as New Zealand. See article in the New Zealand Herald, 6 October 1977,
While some of the UK regulatory agencies have adopted a commendable regime of voluntary disclosure in this area the corridors of Whitehall have tended to remain as impregnable as ever (at least to potentially troublesome researchers), which illustrates that a compulsory regime of disclosure has undeniable benefits. In the regulatory context, where access to information is crucial, especially where third parties such as consumer organisations are concerned, the absence of a statutory right of access in Britain can only be regarded as lamentable.

The second piece of US legislation which should be noted here is the Government in the Sunshine Act of 1976. The general thrust of this legislation is to require federal agencies headed by boards or commissioners to make their proceedings open to public observation. The ambit of the Act extends to the major independent regulatory agencies. The right to observe agency meetings does not extend to participation in deliberations of the agency and there are certain exemptions from the legislative requirements to allow for closed meetings in exceptional circumstances. Again, there is no formal counterpart of this legislation in UK regulatory practice, although many of the individual industry regulators have made some progress in adopting transparent procedures in other areas.

Finally, the Federal Advisory Committee Act of 1972 merits some discussion here. The purpose of this Act is to regulate the operation of advisory committees established

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"Britain keen to match NZ freedom of information", in which Dr Clark was reported as saying at a meeting in Auckland, New Zealand on 5 October 1977: "We take the view that the public's access to their own information is a prerequisite for modern government. We think a mature modern democracy cannot operate without a Freedom of Information Act."


197. Exemptions to the open meeting regime generally parallel the FOIA exemptions. In addition, agencies involved in financial services regulation can hold closed meetings where disclosure of the information discussed might lead to speculative activity or adversely affect institutional stability. Similarly meetings concerning pending litigation involving the agency (such as judicial review proceedings) or cases involving formal adjudication by the agency may also be closed. The legislation requires a detailed procedure to be followed by an agency that wishes to hold closed meetings. Such a decision can be the subject of judicial review under §552(h).

198. 5 USC App (1988), enacted on October 6, 1972 by Public Law 92-463, 86 Stat 770. For a discussion of this legislation, see Cardozo, "The Federal Advisory Committee Act in Operation"
by federal agencies. It sets out various requirements to be met by members of advisory committees, two of the most significant being requirements that committee members must not be subject to any conflict of interest in carrying out their duties, or act as agents of any foreign principal. The Act requires advisory committee meetings to be open to the public and their records are subject to the FOIA disclosure regime. Again this Act has no direct counterpart in the United Kingdom, although some of the industry regulators are currently investigating the setting up of formal advisory committees to assist in the taking of regulatory decisions.

The effect of these statutes on US regulatory practice has been significant. However they cannot be viewed in isolation from the surrounding political context, which has recently adopted a more critical position in relation to participatory procedures. During the Reagan administration in particular, unconstrained participatory action was discouraged in favour of cost effective rule making procedures. While the Reagan innovations in the area of cost-benefit assessment proved to be politically controversial (being alleged by critics to encourage influence pedalling and backstage dealings between industry and the agencies) it became clear during the 1980s that the costs of compliance were to remain a significant part of the picture when the extent of participation fell to be considered. The more recent emphasis on techniques of regulatory negotiation, which will be referred to in more detail below, have also tended to give rise to changing patterns of participation in the administrative process as well as a reduced level of litigation in the form of judicial review proceedings.

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199. In general terms, an advisory committee is defined in s 3 of the Act to include any committee established by statute or organization plan; established to provide advice or recommendations for the president or for federal agencies; and which is not composed wholly of full-time federal officers or employees. The breadth of this definition has generated considerable litigation, some examples of which include Center for Auto Safety v Cox 580 F 2d 689 (DC Cir. 1978); Food Chemical News v Young 900 F 2d 328 (DC Cir. 1990).

200. See for example Kerwin, supra note 38, p 191: "... it is apparent that regulatory negotiation will continue to provide special opportunities for widespread and substantial participation for the foreseeable future. The technique is grounded in principles that are unassailable. When the process works well all current indications are that litigation rates are quite low. No systematic evidence is available about ease of implementation and compliance, but the twin strength of voluntary concurrence with the rule and full information about its content and intent certainly promote the flow of these intended benefits. Whether used on a case-by-case basis or
Before leaving the subject of participation some economic influences in this area should also be noted. If the economic approach is adopted of predicting the popularity of delegated legislation in terms of the associated transaction costs of achieving the equivalent result through the legislative process, certain conclusions become evident. Common sense and experience would suggest that transaction costs will increase in direct proportion to the number of participants involved in the process and also with the degree of diversity of their views. This may lead to the sacrificing of precision in the rule making process for more generalised rules with a greater subjective element.\textsuperscript{201}

This aspect of the transactional costs associated with high levels of public participation in the rule making process should not be overlooked. While requirements of public participation serve to promote the accountability of the regulatory process (and also the overall objectives of a truly democratic society) there is no doubt that if the process of participation is allowed to reign unchecked the result may inevitably be a lack of finality and unnecessary complexity in the rule making process itself. As always, the balancing of these factors is a difficult exercise. The fact that the exercise is difficult should not, however, outweigh the central value of participatory processes.

(vi) Some Recent Reform Initiatives

During 1995, comprehensive regulatory reform legislation was introduced into Congress. The legislation was passed by the House of Representatives in October 1995 but then encountered more intractable difficulties in the Senate and at the time of

\textsuperscript{201} For an interesting discussion of these considerations see Diver, "The Optimal Precision of Administrative Rules" (1983) 93 Yale LJ 65. Diver postulated at pp 75-75 that: "Optimal precision [in the rule making process] varies from rule to rule. The degree of precision appropriate to any particular rule depends on a series of variables peculiar to the rule's author, enforcer, and addressee." The relationship between increased costs of regulatory compliance arising from wide participation requirements and the perceived decline in America's international competitiveness has also been a source of concern. See, for example, Gorney, "Regulation, Competitiveness and Public Participation" in Goldman (ed), \textit{Competitiveness and American Society} (Research in Technology Studies, Volume 7, Associated University Presses, New Jersey, 1993), chapter 6.
writing its future prognosis appears uncertain. The proposed reforms affect the APA procedures in significant ways, which are summarised as follows.\textsuperscript{202}

The legislation which passed the House was contained in two Acts, the Risk Assessment and Cost-Benefit Act (HR1022) and the Regulatory Reform and Relief Act (HR926). HR1022 imposed risk assessment and cost-benefit requirements in relation to agency rules. The provisions particularly applied to major rules (originally defined as rules having an estimated financial impact exceeding $25m) where these related to health, safety or environmental regulations. The measure would also have had the effect of making a substantive amendment to all regulatory statutes so as to require future rules to comply with cost-benefit requirements and to be supported by specified scientific and economic data. The approach taken expanded on cost-benefit principles contained in previous executive orders and set out detailed procedural criteria for implementing risk assessment exercises. Judicial review was available in relation to agency decisions to categorise a rule as a major rule and in relation to the implementation of cost-benefit and risk assessment criteria.

In the Senate the legislation was initially amended to raise the cost-benefit threshold for major rules to $50m and to implement various other amendments to the detailed risk assessment and cost-benefit analysis process. The draft Senate bill replaced the existing §§553 and 706 of the APA by eliminating the mandatory requirement for advanced notice of a proposed rule making and for notification procedures exceeding publication in the Federal Register. A final rule would become effective after 60 days (rather than the existing 30) and other modifications were made to the exemption provisions in §553.

In terms of judicial review, the draft legislation added an additional basis for review under §706, which could be invoked when an applicant was able to establish that a proposed rule was "without substantial support in the rulemaking file, viewed as a

whole, for the asserted or necessary basis, in the case of a rule adopted in a proceeding subject to section 553." Effectively this proposed provision would appear to provide for statutory recognition of a "hard look" approach, under which a reviewing court would be entitled to scrutinise the agency record to ascertain the degree of support for the proposed rule.

The Clinton Administration expressed general support for the reform principles under consideration but considered that there were various difficulties with the proposed legislation, particularly in relation to the cost-benefit criteria as these were defined. The final form of the bill was eventually defeated by a vote in the Senate and the proponents of reform are currently regrouping and considering their position.

All of this political wrangling illustrates two things fairly clearly. The first is that wide-ranging regulatory reform which may serve to alter the balance of power between Congress and the President is likely to prove extremely controversial and has little prospect of being adopted under the present division of political power in the United States.

The second lesson is that a reform measure as radical as the original APA would seem to stand little prospect of being passed today. Indeed, the apparent difficulties associated with effecting major revisions to the existing APA suggest that the existing legislative framework may continue to represent the US model for some considerable time to come. Nevertheless, the fact that all the main political actors in the United States have expressed support for reform measures in the areas proposed (even though they cannot so far reach agreement on the detail) suggests that the need for some

203. For a summary of the Administration's views on the proposed legislation see Katzen, "Administration Perspectives on the 1995 Regulatory Reform Legislation" (1996) 48 Admin LR 331 at 333: "The Administrative Conference's Committee on Rulemaking undertook an ambitious study that indicated that there is much micromanagement by the Congress and much micromanagement by the courts. We have a system where process has become so complex that, if you think about it, we've lost sight of informal rulemaking. I hate to invoke the APA, but section 553 is titled 'Informal rulemaking'. It was intended to be a simple process. It has evolved into anything but. ... I would prefer to go back to simple rulemaking - with real accountability, including real responsibility by the agencies, and real congressional oversight."

204. For a description of the progress of the legislation (or rather the lack thereof) through the US Senate see McSlarrow, "Senate Perspectives on Regulatory Reform Legislation" (1996) 48 Admin LR 328.
change is a real one. Whether and when such change eventuates is entirely another question.

6.5 Difficulties with the US Rule Making Process

6.5.1 Some Problem Areas

This part of the chapter considers some areas which are commonly accepted as giving rise to difficulty in the US rule-making process. The object here is to assess the causes of these difficulties with a view to predicting whether similar problems might arise if rule-making techniques along the lines of the US model were to be generally adopted in the United Kingdom.

The main areas of perceived difficulty with US rule-making involve the alleged cost, complexity and excessive legality of the APA procedures, the effect of wide powers of judicial review of agency rules and the process, popularly termed "ossification" in the current literature, whereby agencies attempt to avoid these difficulties by not pursuing new rule making initiatives.

6.5.2 Problems arising from Cost and Complexity and Excessive Legality

To begin with the issues of cost and complexity and excessive legality, it is perhaps inevitable in any procedure of an adversarial nature, where trial-type processes may be involved along with a heavy input of legal resources, that the whole exercise may become enmeshed in legalities and excessive complexity. In the US regulatory arena, this possibility has long been recognised.205

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205. See for example Fellmeth and Nader, *The Interstate Commerce Omission* (Report by Ralph Nader's Study Group on The Interstate Commerce Commission and Transportation, Grossman Publishers, NY, 1970). (The last word in the title is correctly set out above as "Omission" and not "Commission", which summarises the authors' views on the subject quite succinctly!) Nader's group described the problem of ensuring adequate representation of the public interest in ICC hearings in the following terms at p 11: "The ICC is not a forum for the poor man. It is extraordinarily expensive to make and prepare a case before the ICC. Costs to a litigant include attorney's fees, witnesses' expenses, consultant fees, and printing. The least expensive case opposed will generally cost about $3000 for these fees alone while more complicated cases often run into the hundreds of thousands of dollars."
The figures quoted in the preceding footnote have of course increased greatly in amount over the period of nearly 30 years since this report was written. The practice of some agencies of appointing counsel to represent the public interest recognises the difficulties facing consumer organisations and similar interest groups in relation to representation at regulatory hearings. The growth in recent years of organised and well funded interest groups, particularly in the consumer and environmental protection areas, has also served to improve the situation somewhat. However, there is no doubt that participation in a complex and lengthy regulatory hearing, to which industry interests may devote considerable resources, both in terms of funding and levels of representation, is still beyond the resources of many such groups. It is therefore not surprising that studies of the process of participation by interest groups in rule-making activities indicates that such participation is mainly restricted to well-organised and well-funded groups.

6.5.3 Problems Arising from Wide Powers of Judicial Review.

(i) The Intensity of Judicial Review

The second area of difficulty arises from the wide scope of judicial review in relation to regulatory decisions. The specific statutory powers in the APA give the US federal courts jurisdiction to assess whether an agency's rule-making activities comply with the statutory criteria, as well as with the particular statutory requirements governing the area in question. The corresponding growth in the incidence of judicial review proceedings has exerted a significant influence on agency rule-making processes.

206. Kohlmeier, supra note 129, pp 32-33, observes that: "The theory behind the public counsel is that, even in a big case with lots of lawyers arguing at a public hearing, the lawyers for a company that filed an application and those arguing against the application are representing the selfish interests of their clients, which do not necessarily coincide with the public interest. The rise of what might be termed public defenders inside the agencies also is a tacit admission that the regulators appointed by the President do not contain within their supposed expert knowledge an instinctive recognition of the public interest... The public counsel experiment has been of limited value because agency employees assigned this task have never been given much in the way of funds or manpower to seek out what the consumer's interest is."

207. See for example West, supra note 160, pp 84-85; Kerwin, supra note 38, chapter 5.

208. Under § 706 of the APA a reviewing court is given the power to "hold unlawful and set aside agency action, findings, and conclusions" which are found to be "arbitrary, capricious, an abuse
In the United States context the issue of the intensity of judicial review of agency decisions has been the subject of considerable debate. At one extreme, commentators have argued for an aggressive doctrine of judicial review aimed at asserting the individual rights of litigants in the face of what is perceived to be an unsympathetic administrative bureaucracy. Such an approach, at least in part, reflects the traditional American suspicion of bureaucratic processes and the need for a judicial process to maintain checks and balances in accordance with separation of powers principles.

At the other end of the spectrum, other commentators advocate judicial deference to agency decision-making. Such a view has a long pedigree, dating back at least to the time of Professor Landis and the New Deal era. In more recent times objections to judicial intervention in the decisions of administrative agencies have focused not only

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of discretion, or otherwise not in accordance with law"; or "in excess of statutory jurisdiction, authority or limitations, or short of statutory right"; or "without observance of procedure required by law"; or "unsupported by substantial evidence in a case subject to sections 556 and 557 ..."; or "unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court".

209. Such a view has been particularly popular from time to time among environmental lawyers. See for example Sive, "Some Thoughts of an Environmental Lawyer in the Wilderness of Administrative Law" (1970) 70 Col LR 612, who argues that the court's traditional attitude of deferring to agency decisions causes great harm in the environmental area. Sive advocates a more activist approach to "enable courts to decree in judgments the basic ecological principle that one community's toilet is another's faucet."

210. See for example Rosenbloom, Public Administration and Law. Bench v Bureau in the United States (Marcel Dekker Inc, New York, 1983), p 50: "... it can be seen that members of the Supreme Court have expressed great concern with the persuasiveness of public bureaucracy, its departure from the standards of procedural due process, its tendency to debilitate democratic citizenship under the Constitution, and its ability to frustrate the will of elected political authorities.... If public administrative power is perceived as being exercised largely on an independent basis, the arguments for restraint in the use of judicial review against it lose much of their force. Under such circumstances, judicial review is not necessarily antiamajoritarian." For similar views see Ferejohn and Shipan, "Congressional Influence on Bureaucracy" (1990) 6 J L Econ & Org 1 at 17: "In this sense, statutory judicial review can be a 'democratic' device that induces the agency to be more responsive to congressional preferences than it would be without such a mechanism."; Lively, Judicial Review and the Consent of the Governed (McFarland & Co Inc, North Carolina, 1990) at p 125: "Lost too often amidst the din of competing theories of judicial review is the reality that the institution functions within a system of checks and balances that largely are effective in harnessing and sometimes even enslaving it to popular sentiment." For a more philosophical, recent discussion of the relationship between judicial review and democratic theory see Dworkin, "Equality, Democracy, and Constitution: We the People in Court" (1990) 28 Alberta LR 324. Harlow has explored this relationship from a US/UK comparative basis in her essay "A Special Relationship? American Influences on Judicial Review in England" in Loveland (ed), A Special Relationship? American Influences on Public Law in the UK (Clarendon Press, Oxford, 1995), chapter 3.
on the comparative lack of expertise of the courts but also on whether judges are the most suitable persons for dealing with broadly defined social, economic and political issues, particularly where these involve disputes between a number of parties.\(^{211}\) Professor Schwartz has summarised the essential nature of the problem in succinct terms.\(^{212}\)

The judicial response to the problem has mirrored the division of opinion at the academic level. Initially the US Supreme Court took a relatively cautious approach to the issue of whether or not agency rule-making procedures complied with the APA requirements. In a leading 1971 decision,\(^{213}\) the Supreme Court noted that while the reviewing court's "inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one".\(^{214}\)

Following this initially restrained attitude, the US courts developed, during the 1970s, an approach which came to be termed the "hard look" doctrine.\(^{215}\) This required the reviewing court to have careful regard to the administrative record relating to the

\(^{211}\) For expressions of such a view see Shapiro, *The Supreme Court and Administrative Agencies* (Free Press, New York, 1968), p 102 (arguing that both agencies and courts are equally well placed to reach competent decisions on the same issues); Horowitz, *The Courts and Social Policy* (Brookings Institution, Washington DC, 1977), pp 274-284 (arguing that court procedures are inherently unsuitable for adjudicating on matters of social or economic policy.)

\(^{212}\) Schwartz, *supra* note 38, p 624: "If the scope of review is too broad, agencies are turned into little more than media for the transmission of cases to the courts. That would destroy the value of agencies created to secure the benefit of special knowledge acquired through continuous administration in complicated fields. At the same time, courts should not rubber-stamp agencies; the scope of judicial inquiry must not be so restricted that it prevents full inquiry into the question of legality. If that question cannot be properly explored by the judge, the right to review becomes meaningless."

\(^{213}\) *Citizens to Preserve Overton Park* v *Volpe* 401 US 402 (1971).

\(^{214}\) *Ibid* 416.

\(^{215}\) The term "hard look" itself appears to have been coined by Judge Leventhal of the District of Columbia Circuit Court of Appeals in his judgment in *Greater Boston Television Corp* v *FCC* 444 F 2d 841 (DC Cir. 1970) at 851: "Its supervisory function calls on the court to intervene not merely in case of procedural inadequacies, or bypassing of the mandate in the legislative charter, but more broadly if the court becomes aware, especially from a combination of danger signals, that the agency has not really taken a 'hard look' at the salient problems, and has not genuinely engaged in reasoned decision-making." See also, in similar vein, Leventhal, "Environmental Decisionmaking and the Role of the Courts" (1974) 122 U Pa LR 509 at 511. For examples of judicial applications of the doctrine see *Ethyl Corp* v *EPA* 541 F 2d 1 (DC Cir. 1976) and *Motor Vehicle Manufacturers Association* v *State Farm Mutual Automobile Insurance Co* 463 US 29 (1983). For a discussion of the hard look doctrine in the context of the State Farm case see Sunstein, "Deregulation and the Hard Look Doctrine" [1983] Sup Ct Rev 177.
decision in question. It then had to consider whether, in reaching its decision, the agency had applied the correct criteria, whether it had considered all relevant factors and whether there was adequate support in the record for the material elements in the decision. The "hard look" approach was effectively a form of judicial via media between widely exercised powers of substantive review on the one hand and a high degree of deference by the court to decisions by regulatory agencies on the other.

Under the "hard look" approach an agency might be permitted to reformulate its decision in accordance with guidance given by the court. It might be that the court also has power to remit the matter in dispute back to the agency for further consideration without actually quashing the agency's decision, although the existence of this power remains controversial. Breyer and Stewart have described the general process in a concise passage in their leading text on the subject.

The opportunity which tests of this kind give to the court to scrutinise an agency's record of its decisions has given rise to significant practical consequences in terms of agency practice. It is thought that some regulatory agencies are now tending to adhere to old rules which may already have survived challenges in the courts rather than risk forays into uncharted waters by promulgating new rules which may not survive the process of judicial review. A number of academic commentators have pointed to the results of recent empirical studies of rule-making trends on the part of US regulatory agencies.

216. For recent discussions of whether § 706 of the US APA (requiring the reviewing court to 'hold unlawful and set aside agency action' that falls foul of the criteria in the section) applies to situations where the court has only made a provisional finding that the agency action in question may be questionable and has directed the agency to reconsider or clarify the matter, see Independent US Tanker Owners Committee v Dole 809 F 2d 847 (DC Cir. 1987), cert denied, 484 US 819 (1987); Checkosky v SEC 23 F 3d 452 (DC Cir. 1994); AL Pharma, Inc v Shalala 62 F 3d 1484 (DC Cir. 1995). See also the discussion in Levin, "'Vacation' at Sea: Judicial Remands and the APA" (1996) 21 Admin & Reg Law News, No 3, p 4.

217. Breyer and Stewart, supra note 3, pp 363-364: "However, under the 'hard look' or 'adequate consideration' approach, the court does not condemn the agency's policy choice as irremediably faulty, but simply concludes that the agency has not adequately justified its choice; the normal remedy is a remand for further proceedings in which the agency may attempt to buttress its original policy choice with more extensive analysis and explanation. Under the 'arbitrary and capricious' standard, the court effectively substitutes its judgment for that of the agency on the reasonableness of a substantive policy choice. Under the 'hard look' or 'adequate consideration' approach, it reviews whether the agency has adequately reviewed all relevant factors and considerations and made a reasoned choice. The court may find the decision to be 'arbitrary and capricious' because not adequately explained or justified, but the agency remains free to try again." [Footnotes omitted.]
agencies to justify such a conclusion.\textsuperscript{218} It also seems clear that there is a direct relationship between legislative and judicial insistence on the extension of notice and comment requirements to non-legislative rulemaking and a corresponding reluctance on the part of regulatory agencies to seek to issue non-legislative rules.\textsuperscript{219}

(ii) Judicial Deference to Agency Decisions

The issue of the degree of deference which the court should extend to agency decisions has been the subject of judicial consideration by the US courts in recent times. In a significant 1951 decision the US Supreme Court began to steer judicial review away from the merits of the decision towards the reasonableness of the agency findings of fact, interpreting the APA requirements that an agency decision be supported by substantial evidence as relating to questions of rationality rather than correctness on the merits.\textsuperscript{220} Later decisions during the 1970s adopted a narrower approach to judicial review in areas such as welfare legislation.\textsuperscript{221}

As was noted above, in 1978 the US Supreme Court in the \textit{Vermont Yankee}\textsuperscript{222} case, cast doubt on whether the APA entitled reviewing courts to engraft additional procedural requirements onto agency decisions. Commentators have differed in their views of this development. Professor Stewart, for example, has argued forcefully that the Supreme Court's decision is internally inconsistent, in that the court seems to have accepted that agency review of notice and comment rule making could be conducted on the basis of an agency record, but such a requirement was not itself present in the APA. Stewart therefore maintains that, at the same time as criticising the lower courts for requiring agencies to adopt additional procedural requirements, the Supreme Court has

\begin{itemize}
\item \textsuperscript{218} McGarity, \textit{supra} note 100, p 1387; Pierce, "Unruly Judicial Review of Rulemaking" [1990] Nat Res & Envt 23 at 24; Kerwin, \textit{supra} note 38, pp 250-267.
\item \textsuperscript{219} See Asimow, \textit{supra} note 173.
\item \textsuperscript{220} \textit{Universal Camera Corp v NLRB} 340 US 474 (1951).
\item \textsuperscript{221} See for example \textit{Batterson v Francis} 432 US 416 (1977).
\item \textsuperscript{222} 435 US 519 (1978).
\end{itemize}
based its decision on the same faulty reasoning by recognising the desirability of an agency record, a feature which itself goes beyond the APA requirements.223

Other commentators have taken the view that the Vermont Yankee approach is desirable as otherwise an unrestrained 'hard look' approach would give rise to an unduly stringent standard of review.224 Professor Schwartz, in the most recent edition of his text on US administrative law, chooses not to use the term 'hard look' at all in his treatment of the US process of judicial review.225 Instead he simply emphasises that the review jurisdiction of the court is limited to consideration of the agency's decision and the evidence on which it is based.226

Nevertheless, a 'hard look' approach has attracted some degree of support in the United Kingdom.227 Other UK commentators, such as Craig, have been more sceptical as to the usefulness of such a doctrine, arguing that such an approach would embroil the courts here in contentious policy issues without the assistance of a clear policy framework in the legislation in question.228 One thing is clear, which is that if a 'hard

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223. See Stewart, "Vermont Yankee and the Evolution of Administrative Procedure" (1978) 91 Harv LR 1805 at 1816-1817, where he observes: "The Supreme Court's recognition of a 'record' requirement in such informal proceedings accordingly represents the very sort of procedural innovation which Vermont Yankee purports to condemn... If the Court of Appeals is prohibited from imposing procedural formalities not required by the APA, where does the Supreme Court obtain the authority to impose a 'record' requirement that is not found in the APA?"

224. Breyer, "Vermont Yankee and the Court's Role in the Nuclear Energy Controversy" (1978) 91 Harv LR 1833, who comments that: "The judges are, I believe, intruding too deeply upon the administrative process [through hard look review], perhaps without full realisation of their implicit premises or of the potential consequences."

225. Schwartz, supra note 38.

226. Ibid paragraph 10.2.

227. See for example Harden and Lewis, The Noble Lie (Hutchinson, London, 1986), pp 272-283, who comment as follows at p 278: "What we wish to suggest is that some version of the 'hard look' doctrine might be explored with a view to repairing some of these deficiencies [in administrative decision-making]. The need is to ensure both that reasoned decisions and choices are made and that procedures are adopted to enfranchise potential and actual constituencies who might wish to contest proposals of a major sort." For support in New Zealand for the merits of a 'hard look' approach to judicial review along US lines, see the references cited in note 211 to chapter 8.

228. See Craig, Public Law and Democracy in the United Kingdom and the United States of America (Clarendon Press, Oxford, 1990), pp 182-187. Craig comments at pp 186-187 that: "The very decision to make increased provision for consultation rights, coupled with the desire for a reasoned consideration of policy alternatives by the administrator, will, therefore, lead the courts
look' approach was to be adopted in the United Kingdom substantial changes to the administrative process would be required, one example being the need for regulatory bodies to maintain an adequate record.

The Supreme Court gave further consideration to the issue of deference in its landmark decision in *Chevron v Natural Resources Defense Council* in 1984. This case concerned the EPA's interpretation of the Clean Air Act Amendments of 1977. The EPA had reached a view as to what constituted a "stationary source", which referred to a site which produced air pollution. The 1977 amending legislation contained a prohibition on new construction activity in an area containing such a site where a State Implementation Plan aimed at controlling levels of atmospheric pollution had not been implemented. In the early 1980s the EPA had conducted an informal rule making which replaced its existing rules defining the meaning of a stationary source with a more relaxed definition. This decision was challenged by an environmental group in judicial review proceedings. These were successful in the DC Circuit Court of Appeals, which held that the new EPA definition was inconsistent with the statutory purpose of improving (rather than simply preserving) existing levels of air quality. The EPA rules were therefore struck down as being inconsistent with the statutory purpose.

Chevron appealed successfully to the Supreme Court, which held that the DC Circuit Court of Appeals was in error in giving its own interpretation after determining that there was no clear congressional intent on the issue. Instead, the lower court should have considered whether the agency's view was a reasonable one in the circumstances and if so, it should have given effect to it. In general terms, *Chevron* established that


231. See *Chevron, supra* note 222 at p 843: "Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute."
the courts should be deferential to agency decisions where the congressional intent underlying the statute was unclear and the agency decision was a reasonable interpretation of the statute in the circumstances.

The *Chevron* case has subsequently been followed in several successive decisions of the Supreme Court and the Circuit Courts of Appeals. Indeed at least one academic commentator has suggested that the Supreme Court deliberately set about introducing a restrictive approach to judicial review of agency decisions in order to restrain the excessive enthusiasm for judicial review demonstrated by some of the lower federal courts.

Recent decisions of the Circuit Courts of Appeals have, however, shown that interpretations of the boundaries of the *Chevron* principle can differ and that judicial creativity is a difficult impulse to suppress.

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232. See for example *INS v Cardoza-Fonseca* 480 US 421 (1987) where Justice Scalia observed (at 454): "... courts must give effect to a reasonable agency interpretation of a statute unless that interpretation is inconsistent with a clearly expressed congressional intent."; *National Fuel Gas Supply Corp v FERC* 811 F 2d 1563 (DC Cir. 1987); *American Telephone and Telegraph Co v FCC* 974 F 2d 1351 (DC Cir. 1992) (in which the court found that the FCC's approach lacked a rational basis in the context of an amendment to certain AT&T price caps); *Carnegie Natural Gas Co v FERC* 968 F 2d 1291 (DC Cir. 1992) (where the court upheld the FERC decision on a charging system on the grounds that at least one of the reasons for the agency's decision validly supported it); *Weyburn Broadcasting Ltd Partnership v FCC* 984 F 2d 1220 (DC Cir. 1993) and *Northeast Utilities Service Co v FERC* 993 F 2d 937 (1st Cir. 1993). For a discussion of these decisions see Schwartz, "Some Crucial Issues in Administrative Law" (1993) 28 Tulsa LJ 793, 805-806; 1993 Annual Report, Section of Public Utility, Communications and Transportation Law (ABA, Washington DC, June 1993), pp 28-29; 1994 Annual Report, Section of Public Utility, Communications and Transportation Law (ABA, Washington DC, June 1994), pp 28-29.

233. Pierce, "The Role of the Judiciary in Implementing an Agency Theory of Government" (1989) 64 NYULR 1229 at 1285: "Recent decisions indicate that the Court has felt compelled to select a second-best doctrine that relinquishes all judicial control over administrative agency actions. The source of this compulsion is the growing agency problem within the judicial branch - the Court no longer trusts federal judges to exercise restraint when they are provided any opportunity to impose their policy preferences on the nation."

234. See for example *Nationsbank of North Carolina v Variable Annuity Life Insurance Co* 998 F 2d 1295 (5th Cir. 1993), in which the Fifth Circuit Court of Appeals observed that "Deferece under *Chevron* does not permit administrative agencies to overrule precedents. While administrative agencies serve important functions, these do not include the occlusion of the positivistc declarations of this court." An approach based on *Chevron* deference was applied by the Eleventh Circuit in *Satellite Broadcasting and Communications Association of America v Oman* 17 F 3d 344 (1994), by the DC Circuit in *Aikins v Federal Election Commission* 66 F 3d 348 (DC Cir. 1995) (Judge Silberman dissenting) and by the Third Circuit, again in a majority decision, in *Elizabeth Blackwell Center for Women v Knoll* 61 F 3d 170 (1995). However the Supreme Court declined to defer to a decision of the National Labour Relations Board in *NLRB v Health Care & Retirement Corporation of America* 114 S Ct 1778 (1994). For a discussion of some of the recent cases in this area see Schwartz, "Administrative Law Cases During 1995" (1996) 48 Admin LR 399 at 406-409. Merrill summarises these developments as follows in his
While the *Chevron* principle has been welcomed by agency administrators, its academic reception has not been wholeheartedly supportive. Critics have argued that the courts have abdicated their function of restraining excesses of jurisdiction on the part of regulatory agencies, given that in the final analysis agency powers involve questions of statutory interpretation.\(^{235}\) Other commentators have argued that preserving a strong remedy of judicial review in relation to agency decision making serves to redress what is in effect a constitutionally suspect transfer of the power to make laws from Congress as the Legislature to the President as the Executive.\(^{236}\) Even those commentators such as Starr, who are generally supportive of the *Chevron* approach, are unclear as to some of its implications.\(^{237}\)

Despite these difficulties, it seems clear that an overall judicial approach embodying greater deference to agency decision making is here to stay in the United States, at least in the foreseeable future. Such an approach, which necessarily serves to reduce the

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\(^{235}\) See Schwartz *supra* note 38 at p 807: "The *Chevron* era on paper represents a rejection of the discretionary approach and an embrace of a pure mandatory regime. Now, however, the realm of mandatory deference has vastly expanded to include a presumption of delegation in all cases where a federal statute is ambiguous or unclear. As we have seen, however, in practice the discretionary approach has lived on, in the shadows of *Chevron*, and in considerable tension with its expanded delegation theory."

\(^{236}\) See Farina, "Statutory Interpretation and the Balance of Power in the Administrative State" (1989) 89 Col LR 452; Eskridge and Ferejohn, "Making the Deal Stick: Enforcing the Original Constitutional Structure of Lawmaking in the Modern Regulatory State" (1992) 8 J L Econ & Org 165 at 182-186. The authors note at 183: "... the transfer of lawmaking power from Congress to the president is even more dramatic, and invulnerable to attack through the legislative veto. We now demonstrate in this section that the introduction of aggressive judicial review of agency rule-making is a more effective remedy for the constitutional dilemma (in these cases) than is the legislative veto."

\(^{237}\) See Starr, *supra* note 230, at p 299: "*Chevron* also raised questions regarding the application of the deference principle. These unresolved issues include whether the 'sliding scale' approach to deference retains any validity; whether courts will be more willing to hold an interpretation 'reasonable' when the statute relates to the core powers of the Executive; and what a reviewing court should do when faced with conflicting interpretations of the same statute by different agencies." See also Anthony, "Which Agency Interpretations Should Bind Citizens and the Courts?" (1990) 7 Yale J on Reg 1 at 4: "Should the courts under *Chevron* be bound to accept (and not merely to consider) reasonable agency interpretations expressed in informal formats? The present study addresses this question, and yields generally negative answers. Where the format is an informal one, it ordinarily does not carry the force of law, and a reviewing court is not bound by the agency interpretation, though it should give special consideration to the agency opinion."
breadth of the remedy of judicial review, has the inevitable effect of bringing the US and UK approaches to the use of this remedy closer together, although wide divergences of practice continue to exist between both jurisdictions. As will be seen in chapter 8, the UK courts have also tended to accord reasonable deference to agency decision making, although, as with US experience, some divergences from this pattern can be found. In English law there is a continuing debate as to the extent to which error of fact should properly be subject to judicial review in certain circumstances. Some recent cases are discussed by the authors of the 5th edition of de Smith.

In theory there is not a great deal of divergence in the legal basis for the remedy of judicial review as between Britain and the United States. The divergence arises in the area of practice, with the greater activism of some American judges, particularly at the appellate level.

A recent, comprehensive study by Judge Wald of judicial review of agency rule-making in the Court of Appeals for the District of Columbia has indicated that, while some judicial overreaching can be detected in this area in certain cases, the overall experience with the degree of intrusiveness of judicial review cases in the DC Circuit was not as pessimistic as the predictions of some commentators might suggest.

238. See the discussion in part 8.3.5 of chapter 8.

239. See de Smith, Woolf and Jowell, Judicial Review of Administrative Action (Sweet & Maxwell, London, 5th ed, 1995), paras 5-091 - 5-096. As the learned authors note at para 5-095: "Should we now go further and adopt a general rule empowering the courts to set aside findings of fact by statutory tribunals and administrative authorities if 'unsupported by substantial evidence'? If such a rule were to become meaningful, it would require bodies which at present conduct their proceedings informally to have verbatim transcripts or to keep detailed notes of evidence. If the administrative findings were made partly on the basis of inspection and views, a body of superinspectors would be needed." For examples of some recent decisions which lend support to such an approach see Smith v Inner London Education Authority [1978] 1 All ER 411; Secretary of State for Education and Science v Tameside MBC [1977] AC 1014; New Zealand Fishing Industry Association Inc v Minister of Agriculture and Fisheries [1988] 1 NZLR 544.

240. Wald, "Regulation at Risk: Are Courts Part of the Solution or Most of the Problem?" (1994) 67 Sth Calif LR 621 at 636-637: "I also looked in my mini-survey to see how often in the course of a year the agency took a hit from our court on one of its long-time-in-the-making rules. Out of the thirty-six cases, the agency's judgment was upheld in its entirety nineteen times or more than fifty percent. In the remaining seventeen cases, a portion of the rule or rules was remanded; although in most of those cases the key portions of the rule survived. In four of these cases parts of the rule went back for failure to provide the required APA notice and comment ... The court sent the rule or parts thereof back for failure of the agency adequately to explain its rationale in six cases; in seven cases, it thought the agency had interpreted the statute in a way that contradicted the clear intent of Congress; in a few cases it was a combination of these two reasons that doomed the rules." [Footnotes omitted.]
However, Judge Wald's view of the performance of the District of Columbia Circuit in relation to judicial review of agency actions does not represent the only view of the matter. Other commentators have pointed to the fact that, at least during the latter part of the 1970s, and continuing well into the 1980s, the judges of the DC Circuit Court of Appeals were willing to adopt a quite interventionist stance in relation to reversals of agency rule making activities.241

While the debate continues on the issue of how well agency rules survive the process of judicial review, it is perhaps more difficult to evaluate the extent to which wide powers of judicial review tend to deter agencies from seeking to issue new rules in the first place. There seems little doubt however that the greater willingness of the US courts to embark on reviews of rulemaking procedures has led to a correspondingly increased reluctance on the part of regulatory agencies to embark on programmes for the issue of new rules. This phenomenon merits further examination.

6.5.4 Ossification of the Rulemaking Process

Professor McGarity has expressed a forthright view of the so-called ossification of the modern US rulemaking process.242 It is certainly evident that agencies which now seek to issue new rules face a number of hurdles. As a result of increasing judicial scrutiny

241. See for example: Scalia, "Vermont Yankee: the APA, the DC Circuit, and the Supreme Court" [1978] Sup Ct Rev 345; the study by the New York University Law Review: "Editorial Note - Disagreement in DC: the relationship between the Supreme Court and the DC Circuit and its implications for a National Court of Appeals" (1984) 59 NYULR 1048. See also Pierce, "Two Problems in Administrative Law: Political Polarity on the District of Columbia Circuit and Judicial Deterrence of Agency Rulemaking" (1988) 38 Duke LJ 300 at 327: "The appellate courts have made the process of policymaking by rulemaking extraordinarily expensive and time consuming by imposing unrealistic requirements on agencies. The politically polarized and judicially activist DC Circuit, which dominated judicial review of agency rule making, has added a high degree of risk to the process of policymaking through rulemaking. If these two problems persist, agencies will have to follow the lead of the NHTSA - they will cease attempting to make policy decisions in any systematic manner."

242. McGarity, supra note 100 at 1385: "Although informal rulemaking is still an exceedingly effective tool for eliciting public participation in administrative policymaking, it has not evolved into the flexible and efficient process that its early supporters originally envisioned. During the last fifteen years the rulemaking process has become increasingly rigid and burdensome. An assortment of analytical requirements have been imposed on the simple rulemaking model, and evolving judicial doctrines have obliged agencies to take greater pains to ensure that the technical basis for rules are capable of withstanding judicial scrutiny."
of the rulemaking process they are required to prepare detailed preambles for their rules together with comprehensive technical supporting data. The process of obtaining and addressing comments received from the public and interested parties is increasingly onerous. From delays of one to two years during the 1960s, periods of five and six years or more are now not uncommon from the time notice of a proposed rulemaking is issued up to the time the final form of the rule is adopted.\textsuperscript{243}

There are a number of discernible causes for this process of ossification. Much rulemaking activity involves topics which are politically controversial and which attract considerable opposition from, and interest on the part of, industry groups. Many of these groups are not anxious to see the proposed rules adopted, either at all or at least not without significant modification.\textsuperscript{244} However, responsibility for the delays which result cannot be laid entirely at the door of industry. Consumer and environmental organisations have also utilised the process to similar effect when it has suited their interests to do so.\textsuperscript{245}

The institutional context in which US rulemaking operates has also complicated the process. The contest between Congress and the President over the management and oversight of the rulemaking process has been referred to earlier in this chapter. The resultant requirement of demonstrating the cost benefit effectiveness of proposed agency rules, while no doubt laudable in intention, has also served to impose greater administrative burdens on the regulatory agencies. As has been noted above, the

\textsuperscript{243} For some particularly glaring examples of long delays in the US rulemaking process see McGarity, \textit{supra} note 100, pp 1387-1396; Wald, \textit{supra} note 240, pp 625-627.

\textsuperscript{244} See McGarity, \textit{supra} note 100 at p 1397; "Because it [informal rulemaking] was initially so efficient in forewarning individuals and groups about how the agency was planning to affect them, it has provided powerful political constituencies with ample opportunity to mobilize against individual rulemaking initiatives. The political background has thus shifted from the legislature to the bureaucracy. When rulemaking is aimed at advancing progressive social agendas, regulatees and their trade associations have fiercely resisted the rulemaking process, seeking to lard it up with procedural, structural, and analytical trappings that have the predictable effect of slowing down the agency." See also Eisner, "Agency Delay in Informal Rulemaking" (1989) 3 Admin LJ 7 at 8.

\textsuperscript{245} See \textit{Vermont Yankee}, \textit{supra} note 176, which can be regarded as falling within this category of cases. Other examples are \textit{Klepp v Sierra Club} 427 US 390 (1976) and \textit{Warm Springs Dam Task Force v Gribble} 621 F 2d 1017 (9th Cir. 1980).
federal judiciary, far from being the least dangerous branch, has also sought from time
to time to exert substantial influence over the conduct of the rulemaking process.\textsuperscript{246}

The subject matter of modern rulemaking procedures is also not conducive to
expedition in many instances. In areas which involve complex scientific and economic
issues, the resources of the agencies themselves have often been quickly exceeded,
necessitating advice from external sources and experts. Opponents of proposed rules
have also not been slow to obtain their own expert advice and to seek to use it to
influence the attitude of the agencies. One result of this process has been to cause
many agency rule making initiatives to become bogged down in technical detail, so that
the entire rulemaking process is frustrated and delayed.\textsuperscript{247}

\section*{6.6 Possible Solutions to Problems Associated with the US Regulatory Process}

Before assessing the extent to which a modified version of the US regulatory process
can be applied to other jurisdictions such as the United Kingdom, some consideration
needs to be given to possible solutions to the problems which have emerged.
Subsequent chapters will evaluate whether such problems and solutions might also be
applicable in the United Kingdom context.

\begin{footnotesize}
\begin{enumerate}
\item It was Alexander Hamilton who coined the phrase "the least dangerous" branch in relation to the
judiciary. (See his essay in \textit{The Federalist No 78} (Clinton Rossiter (ed), Penguin Books, New
York, 1961) at p 465.) Contemporary opinions differ as to whether this perception still holds
true. For a recent discussion see Flaherty, "The Most Dangerous Branch" (1996) 105 Yale LJ
1725. See also McGarity, \textit{supra} note 100, p 1419: "The predictable result of stringent 'hard look'
judicial review of complex rulemaking is ossification. Because the agencies perceive that the
reviewing courts are inconsistent in the degree to which they are deferential, they are constrained
to prepare for the worst-case scenario on judicial review. This can be extremely resource-
intensive and time consuming. Moreover, since the criteria for substantive judicial review are
the same for repealing old rules as for promulgating new rules the agencies are equally chary of
revisiting old rules, even in the name of flexibility."
\item See McGarity, \textit{supra} note 100, pp 1407-1410.
\end{enumerate}
\end{footnotesize}
6.6.1 Reforming Agency Structures and Procedures

It will be apparent from the foregoing discussion that US regulatory procedures such as the rulemaking process are demanding both in terms of resources of personnel and funding requirements. Like administrative procedures in many other jurisdictions, US rulemaking suffers from funding limitations, which obviously affect the ability of agencies to undertake effective rulemaking activities. However, recognising the political difficulties associated with increasing budgets for rulemaking activities, US commentators have suggested that the best solution to these difficulties is to achieve better and more efficient use of existing agency resources.

This might be done by more intensive scrutiny of proposed rules prior to their issuance, better co-ordination between agencies having responsibility for particular rulemaking areas and attention to the setting of priorities and improved internal management. US government and quasi-government bodies have suggested similar reforms along these lines. Adjudicative regulatory processes might similarly be improved by devoting resources to increasing the quality and training of the administrative law judges.

Proposals for modified Congressional and Executive oversight of agency procedures have also been advanced. While US academic commentators are generally agreed that some degree of review along these lines is required, views have also been expressed

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248. The need for adequate funding of agency rulemaking activities, and the current deficiencies in funding levels, have been recognised by a number of US commentators. See for example Bryner, supra note 160, chapter 7; Kerwin, supra note 38, pp 293-294; Eisner, supra note 244 at p 8.

249. For some suggestions as to the mechanics of such a process see Wald, supra note 240, pp 639-640.

250. See for example McGarity, supra note 100, pp 1437-1438 (advocating improved liaison between agencies such as the OSHA and government departments such as the Department of Labor.)


253. See for example DeMuth and Ginsburg, "White House Review of Agency Rulemaking" (1986) 99 Harv LR 1075 at 1088: "To be sure, different presidents, representing different parties in
that the present level of scrutiny is excessive and should be cut back.254 This would necessarily involve the Office of Management and Budgets relinquishing some of its powers of oversight, an outcome which is probably unrealistic in an era where the US political scene has been characterised, at least during much of President Clinton's first term of office, by a Democrat White House and a Republican Congress. Similarly decreased involvement by Congress, either through legislation or a lower level of scrutiny through Congressional oversight hearings, might be perceived as entailing a shift of power in favour of the executive and is no doubt a similarly unrealistic prospect in the current US political climate.

Finally, the role of the now defunct Administrative Conference of the United States (ACUS) should be noted here. The ACUS was established by Congress in 1964 to study the organisation and management of US federal government agencies with a view to suggesting improvements in administrative procedures. It consisted of up to 101 members drawn from leading federal law officers, academics with an interest in the administrative process and various private sector experts. The Conference had powers of recommendation only and these were exercised following debate among the members on selected topics, often based on consultant's reports prepared by leading authorities in particular areas.255

The ACUS took pains to ensure that its reports were practically oriented, rather than being merely of academic interest. It published widely on a number of areas of different times, will give their own content to these procedures. The criteria by which a particular administration evaluates regulations may change. But every president has a program, and no program can be implemented in the modern regulatory state without regulatory planning and regulatory review by the Executive Office of the President." For a defence of the role of Congressional oversight in this area see Markey, "Congress to Administrative Agencies: Creator, Oversee and Partner" (1990) 67 Duke LJ 967.

254. For opinions to this effect see McGarity, supra note 100, pp 1448-1451; Bryner, supra note 160, pp 215-218; Percival, "Checks Without Balance: Executive Office Oversight of the Environmental Protection Agency" (1991) 54 Law & Contemp Probs 127. See also Wilkins and Hunt, "Agency Discretion and Advances in Regulatory Theory: Flexible Agency Approaches Toward the Regulated Community as a Model for the Congress-Agency Relationship" (1995) 63 Geo Wash LR 479, who contend that a less constrained relationship between Congress and the agencies would mirror recent developments in incentive-based regulation and would avoid some of the traditional deficiencies of 'command and control' methods, namely inflexibility, inefficiency and lack of initiative.

administrative procedure, including the rule making process, freedom of information and sunshine legislation and federal agency use of ADR, arbitration and negotiated rulemaking techniques. The ACUS also distinguished itself for expressing well researched opinions showing considerable foresight and common sense. Its recommendations led directly to the passing of the Negotiated Rulemaking Act and the Alternative Dispute Resolution Act in 1990 as well as useful initiatives in a number of other areas.

All of this came to a sudden end on 13 September 1995 when a Senate Committee decided to save US$1.8m a year by cutting funding to the ACUS, which ceased operations a few weeks later on 31 October, a remarkably short-sighted decision which was lamented and criticised by a number of commentators. This saga furnishes some lessons about political expediency, but for present purposes one of the most telling is that regulatory reform and mechanisms designed to bring about its achievement frequently have a low ranking when it comes to allocating government funding. Potential savings in the future in other agencies may be less persuasive than immediate cost cutting in the agency which effects those improvements.

256. The range of topics addressed by the Conference is described in Edles, "The Administrative Conference: Entering a Third Decade of Practical Scholarship" (1989) 41 Admin LR 399; Pou, \textit{ibid}, pp 68-83.

257. I am grateful to Mr Gary J Edles, former General Counsel to the ACUS prior to its dissolution by Congress, for providing me with a copy of these and a number of other useful ACUS publications on the federal administrative process in October 1995. I should also express my appreciation to Professor Cosmo Graham of the Law Faculty, University of Hull, for providing me with contact details for the ACUS and other useful American sources.

258. See article by McCarthy in the \textit{Washington Post} of November 7, 1995: "Mourning an Agency Mugged by Congress" which noted: "With funeral plans pending, relatives of the late conference were dumbfounded that a Republican Congress had done in an agency that for 27 years had been practising so-called republican ideals: pushing federal agencies to be efficient, smaller and less wasteful. For one example, the Social Security Administration recently estimated that an ACUS recommendation to improve its appeals process means an annual saving of $85 million." See also Funk, "R.I.P. ACUS" (1996) 21 Admin & Reg Law News, No 2, p 1, who noted: "This action may have saved $1.8 million a year, but it eliminated the only federal agency chartered specifically to ensure that federal agency programs are administered fairly, efficiently and effectively. This 'penny-wise, pound-foolish' decision was made despite entreaties on behalf of the Conference from such bipartisan sources as: Justices Stephen Breyer, a Conference member, and Antonin Scalia, a former Conference chair..."
6.6.2 Modified Judicial Review Procedures

Proposals have also been advanced aimed at streamlining or containing the process of judicial review which many commentators consider to be burgeoning out of control. These have included periodic pleas to the reviewing courts to adopt a more consistently deferential approach to agency decision making, including some dilution of the "hard look" doctrine, and a reduction in the intensity of substantive judicial review.259

However, reducing the scope for judicial review of agency making is in itself controversial. Such a move is not likely to be supported either by regulated interests or by consumer and environmental groups, all of which might be expected to favour preservation of extensive powers to challenge agency rulemaking through the judicial process. Similarly the traditional American distrust of government institutions may also mean there is doubtful political capital to be made out of proposals to limit judicial review of administrative decisions.260

Less radical suggestions for reforming the process of judicial review revolve around the introduction of procedural innovations in the DC Circuit Court of Appeals, where the majority of challenges to federal regulatory activity are heard. These include preserving the same court panel for the duration of each judicial review case and greater judicial involvement in the early management of such cases, which might lead to the abandonment of judicial review challenges or the making of suitable amendments to the rules under challenge at an early stage.261

Other, more extensive, structural changes include periodic suggestions calling for a specialised administrative law court which would hear judicial review cases in all the US circuits,262 or an insistence on timely judicial review at an early stage of the rulemaking process (perhaps backed up by appropriate statutory provisions) and


260. For a discussion of these features of the American political process see Mashaw and Harfst, "Regulation and Legal Culture: The Case of Motor Vehicle Safety" (1987) 4 Yale J on Reg 257, 263.

261. For suggestions along these lines see Wald, *supra* note 240, pp 640-642.

restrictions on the grounds under which agency rules may be challenged.\textsuperscript{263} Such proposals would tend to bring the process of judicial review in the United States closer to that which applies in the United Kingdom under the Order 53 procedure. It is perhaps ironic that while some academic commentators in the United Kingdom lay a measure of responsibility for the perceived failings in the UK regulatory process at the door of an unduly restrictive doctrine of judicial review,\textsuperscript{264} commentators in the United States are tending to the converse view that failings in the regulatory process are attributable to excessively wide powers in this area.

6.6.3 Alternatives to Rulemaking/Use of Consensual Procedures

Other suggested solutions to the problems besetting US regulation include bypassing the rulemaking process altogether, just as ADR techniques seek to provide an alternative to the traditional processes of litigation. Various approaches have been suggested in this context.\textsuperscript{265} These include the use of processes of a consensual nature such as regulatory negotiation and structured co-operative techniques between regulators and regulatees. Such proposals are not particularly novel. Indeed the need to develop such methods to overcome the malaise affecting US regulation has been recognised for a number of years.\textsuperscript{266}

Like ADR techniques in the area of dispute resolution, techniques of regulatory negotiation seek to overcome some of the perceived drawbacks in the adversarial process when applied to the regulatory context. Perceived difficulties with the adversarial model have been canvassed extensively in relation to the ordinary processes

\textsuperscript{263} See for example Wald, \textit{supra} note 240, pp 642-643.


\textsuperscript{265} For a summary of some suggested techniques in this area see Harter and Eads, "Policy Instruments, Institutions, and Objectives: An Analytical Framework for assessing 'Alternatives' to Regulation" (1985) 37 Admin LR 221.

\textsuperscript{266} For some examples of relatively early academic work in this area see Boyer, " Alternatives to Administrative Trial Type Hearings for Resolving Complex Scientific, Economic and Social Issues" (1972) 71 Mich LR 111; Harter, "Negotiating Regulations: A Cure for Malaise" (1982) 71 Georgetown LJ 1.
of civil litigation. Adversarial procedures tend to give rise to extreme positions and often polarise the attitudes of the participants. Opposing parties often strive to achieve technical and procedural advantages and strict application of the rules of evidence may restrict the material which can be presented to the tribunal. Proceedings may be dictated by the approaches and personalities of the legal representatives, which in turn can make it difficult for the parties to achieve a satisfactory pre-trial settlement. Furthermore, as Professor Fuller has shown in his well known article on the subject, trial type procedures are often not well suited to the determination of polycentric disputes involving a number of parties with disparate interests, a situation which not infrequently arises in the regulatory context. These perceived advantages of consensual processes have been summarised well by Harter.

Moves towards negotiated rulemaking have received some recent encouragement in the United States following the passing of the Negotiated Rulemaking Act of 1990. Where parties choose to follow this statutory procedure, an agency representative meets with representatives of the regulated bodies and other affected parties and attempts to reach agreement on the form of agency rules with the assistance of a mediating agent known as a "facilitator". The APA notice and comment requirements continue to apply to negotiated rulemaking under the 1990 Act.


268. Harter, supra note 266, p 28: "Negotiating has many advantages over the adversarial process. The parties participate directly and immediately in the decision. They share in its development and concur with it, rather than 'participate' by submitting information that the decisionmaker considers in reaching the decision. Frequently, those who participate in the negotiation are closer to the ultimate decisionmaking authority of the interest they represent than traditional intermediaries that represent the interest in an adversarial proceeding. Thus, participants in negotiations can make substantive decisions, rather than acting as experts in the decisionmaking process. In addition, negotiation can be a less expensive means of decisionmaking because it reduces the need to engage in defensive research or anticipation of arguments made by adversaries."


Some anticipated difficulties with negotiated rulemaking under the 1990 Act mirror corresponding criticisms which have been made of ADR processes in the dispute resolution area. These include the difficulty of arranging representative participation in the negotiations and the lack of structured, mandatory processes to compel the parties to reach agreement. Professor Rose-Ackerman has identified several areas of difficulty with such consensual processes.271

Negotiated rulemaking depends for its success on the supposition that the parties to the rulemaking process wish to obtain agreement as efficiently and expeditiously as possible. However, there are frequently instances where regulated interests are antagonistic to the regulatory process in general and to the formulation of new rules in particular, especially in controversial areas. In such cases those interests may in fact prefer to utilise the legal process to hinder rule making activities rather than to help them to a conclusion. Consensual techniques of negotiated rule making are unlikely to be attractive to such parties. As commentators such as Kerwin have realistically observed, negotiated rulemaking is likely to be most successful where such circumstances do not exist.272

The undeniable advantage of processes of negotiated rule making are that, when successful, they can serve to short circuit much of the crippling delay which has been a feature of US rulemaking in recent years. While considerable input of time and resources is needed to achieve a successful regulatory negotiation, the costs involved are also likely to be considerably lower than if the process is protracted over a number of years and is accompanied by challenges in the courts by way of judicial review.

271. Rose-Ackerman, supra note 270, p 1284: "Regulatory negotiation is predicated on reaching a consensus. But consensus can be sought by many methods. Considerable controversy has centred around the form of the negotiation. Should government officials participate? Should meetings be open or private? Should a mediator or moderator guide the process? Should the authorities provide experts to evaluate the technical aspects of the problem? If the system of representation is satisfactory, government officials need not attend, and meetings can be private. If it is not, the addition of bureaucrats and the creation of a more open process are unlikely to compensate satisfactorily for this failure. In such cases, the state should either follow normal APA requirements or submit the issue to the legislature for resolution by majoritarian processes."

272. Kerwin, supra note 38, p 187: "Perhaps the most basic criterion for selecting candidates for regulatory negotiation is to choose those rules that do not entail conflict over fundamental, deeply held values. Where the basic disagreement is not about how much or little to regulate, or about the means to achieve a particular objective, but rather about the morality of government intervention, per se, the prospects for regulatory negotiation diminish substantially."
Preliminary indications are that where such a system works satisfactorily, use of the litigation process and the incidence of judicial review proceedings are comparatively low, leading to significant savings in legal costs and reductions in delay.273

The use of ADR procedures in the regulatory process has also received some Congressional attention, in the form of a new subchapter to the Administrative Procedure Act entitled *Alternative Means of Dispute Resolution in the Administrative Process*.274 This Act provided for agencies to employ consensual dispute resolution procedures under certain defined conditions, including in cases where the precedent value of the decision or its policy implications are limited, or where third party rights and the need to have a formal agency record are not significant factors. A conciliator (called a 'neutral' in the Act) may be appointed and is bound by strict confidentiality requirements. Arbitration procedures leading to a formal award may also be invoked. An agency decision not to employ a dispute resolution procedure cannot itself be subjected to judicial review. These developments mirror the increasing popularity of consensual procedures in other jurisdictions in relation to regulatory disputes and the use of such processes will be discussed further in chapters 10 and 11.

6.6.4 Summary

All of these suggested reforms have been made in order to cure the ills of a system which has become increasingly unwieldy and which not even its most devoted adherents would claim was functioning entirely satisfactorily at the present time. The benefits of regulatory procedures such as agency rulemaking were originally perceived as flowing from their role in structuring administrative discretion, and allowing agencies to formulate policy without reliance on ad hoc processes of adjudication, thereby furthering democratic ends and reducing constitutional objections to the

273. See Kerwin, supra note 38, p 191; McGarity, supra note 100, pp 1438-1440. As McGarity notes at p 1440: "Negotiated rule making is a very useful tool that should be in every regulatory agency's toolbox. When applied in the proper context, it can greatly reduce the time and effort all of the parties devote to rulemaking initiatives. It is not, however, a magic cure for the ills of ossification."

validity of the administrative process.275 Commendable though these objectives may have been, the system of rule making as a regulatory technique in the United States is now in need of an overhaul in various areas.

It suffices to close this part of the discussion by reminding ourselves that while the administrative agency with its broad delegated powers seems to be a permanent fixture of the American regulatory scene, the constitutional status of the agencies is a matter which remains controversial in the United States. Debate on this issue sometimes generates more heat than light and has certainly given rise to strongly expressed views. Some trenchant criticisms of the delegation of broad quasi-legislative powers in this way have been expressed.276 Such criticisms may have special force when applied to federal systems such as that of the United States which function under specific constitutional provisions interpreted in the light of the separation of powers doctrine. In the United Kingdom, where Parliament has supreme law making authority and there is no written constitution in existence providing the basis for a formal separation of powers, a similar argument would be much more difficult to advance.

However, the above discussion does illustrate that the vesting of broad rule making powers in administrative agencies has been the subject of considerable academic disquiet in the US context from a constitutional perspective and the debate shows little sign of subsiding. Commentators on the United Kingdom regulatory scene have made


276. For recent criticisms of wide (or in some cases any) delegations of power by Congress to the administrative agencies see Lowi, supra note 125, (who argues that the delegation of decision making power away from Congress, which is responsible to the electorate, to the administrative agencies, which are not, is a threat of fundamental proportions to the existence of constitutional democracy in the United States); Mayton, "The Possibilities of Collective Choice: Arrow's Theorem, Article I, and the Delegation of Legislative Power to Administrative Agencies" (1986) 35 Duke LJ 948; Sunstein, "Constitutionalism After the New Deal" (1987) 101 Harv LR 421; Schoenbrod, Power Without Responsibility: How Congress abuses the People through Delegation (Yale UP, New Haven, 1993), who trenchantly criticises Congress for abdicating its policy making role in favour of unelected agencies; Lawson, "The Rise and Rise of the Administrative State" (1994) 107 Harv LR 1231 (who expresses the view at p 1233 that the "modern administrative state openly flouts almost every important structural precept of the American constitutional order."); Hamilton, "Power, Responsibility and Republican Democracy" (1995) 93 Mich LR 1539.
the point that the fact that British legislators have not had to focus on issues of constitutional structure in the same way as in America has led to a corresponding lack of concern with the design of regulatory institutions and their constitutional implications. It should not be overlooked that democratic institutions flourish only under conditions which encourage participation by, and ensure fairness to, all affected parties. The process of economic regulation, in whichever democracy it may be found, is no exception.

6.7 Applications to the UK Context

It is fair to say that structured rule making and adjudicative procedures have not attracted a great deal of support in the context of UK economic regulation to date. Those commentators who have considered the area have noted some of the shortcomings in American rule making techniques, including in particular the cost and expense of trial-type adjudication. Structured participation procedures have been utilised to a limited extent, particularly in areas such as land use planning and development control, and such techniques are being developed in the field of utilities regulation, as will be examined further in chapter 9.

There have been periodic expressions of support in the United Kingdom for the adoption of modified notice and comment procedures along US lines. On the other

277. Graham and Prosser, supra note 264 at p 256 note that: "Inspired by separation-of-powers concerns, notably in the divorce between adjudication and rule-making, this statute [the APA] sets down a general framework for administrative decision-making. It is worth emphasising that nothing like this exists in the United Kingdom; there is no general set of principles for decision making."


279. Baldwin, Regulation in Question. The Growing Agenda (Merck Sharp & Dohme publication, London, June 1995), p 131: "Such procedures might enhance regulators' claims to be acting with proper fairness and accountability. Issues would arise as to the rules to be covered by such a requirement; the definition of exemptions from notice and comment procedure (which include, in the US, general statements of policy); distinguishing between rules and decisions; the dangers of legalism and defensiveness; and biases in favour of well-organised parties who are adept at working with such procedures. Such difficulties are not, however, insurmountable, and, on
hand some concern has been expressed that regulation on the basis of a detailed system of rule making, with its attendant risk of legalistic and expensive hearing procedures, is inherently unsuitable for British circumstances. In a recent paper, Professor Graham points, for example, to the fact that government policy guidance to regulators in relation to their statutory duties may be a more effective method of proceeding than the adoption of APA type procedures in the United Kingdom.²⁸⁰

This writer, for his part, adheres to the view that it is possible to apply a modified system of American regulatory techniques in the British regulatory context, providing such a system is structured in a way which avoids the significant difficulties which characterise the US system. The obvious failings of the US system in certain areas should not obscure the central fact that consultation and participation requirements are desirable goals in themselves in carrying out the process of economic regulation. The task of devising such mechanisms will be attempted in the chapters which follow.

²⁸⁰ See Graham, Is There a Crisis in Regulatory Accountability? (CRI Discussion Paper No. 13, London, November 1995). Professor Graham notes at p 55 of his paper: "It should be clear, however, that I do not think that the American Administrative Procedure Act's division between rule-making and adjudication is likely to be suitable in British circumstances."
APPENDIX I

EXCERPTS FROM THE FEDERAL ADMINISTRATIVE PROCEDURE ACT

Chapter 5, Subchapter II - Administrative Procedure

§551. Definitions

For the purpose of this subchapter -

(1) "agency" means each authority of the Government of the United States, whether or not it is within or subject to review by another agency, but does not include -

(A) the Congress;
(B) the courts of the United States;
(C) the governments of the territories or possessions of the United States;
(D) the government of the District of Columbia; or except as to the requirements of section 552 of this title -
(E) agencies composed of representatives of the parties or of representatives or organizations of the parties to the disputes determined by them;

[remainder of (1) and all of (2) and (3) omitted].

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing;

(5) "rule making" means agency process for formulating, amending, or repealing a rule;

(6) "order" means the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter other than rule making but including licensing;

(7) "adjudication" means agency process for the formulation of an order;
(13) "agency action" includes the whole or a part of an agency rule, order, license, sanction, relief, or the equivalent or denial thereof, or failure to act;

[(14) omitted].

§552. Public Information; Agency Rules, Opinions, Orders, Records, and Proceedings.

(a) Each agency shall make available to the public information as follows:

(1) Each agency shall separately state and currently publish in the Federal Register for the guidance of the public -

(A) descriptions of its central and field organization and the established places at which, the employees (and in the case of a uniformed service, the members) from whom, and the methods whereby, the public may obtain information, make submittals or requests, or obtain decisions;

(B) statements of the general course and method by which its functions are channelled and determined, including the nature and requirements of all formal and informal procedures available;

(C) rules of procedure, descriptions of forms available or the places at which forms may be obtained, and instructions as to the scope and contents of all papers, reports, or examinations;

(D) substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency; and

(E) each amendment, revision, or repeal of the foregoing.

Except to the extent that a person has actual and timely notice of the terms thereof, a person may not in any manner be required to resort to, or be adversely affected by, a matter required to be published in the Federal Register and not so published. For the purpose of this paragraph, matter reasonably available to the class of persons affected thereby is deemed published in the Federal Register when incorporated by reference therein with the approval of the Director of the Federal Register.

(2) Each agency, in accordance with published rules, shall make available for public inspection and copying -
final opinions, including concurring and dissenting opinions, as well as orders, made in the adjudication of cases;

(B) those statements of policy and interpretations which have been adopted by the agency and are not published in the Federal Register; and

(C) administrative staff manuals and instructions to staff that affect a member of the public; unless the materials are promptly published and copies offered for sale.

[remainder of §552 omitted].

§553. Rulemaking

(a) This section applies, accordingly to the provisions thereof, except to the extent that there is involved-

(1) a military or foreign affairs function of the United States: or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rulemaking shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include -

(1) a statement of the time, place and nature of public rulemaking proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, this subsection does not apply-

(a) to interpretative rules, general statements of policy, or rules of agency organisation, procedure, or practice: or

(b) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.
(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rulemaking through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substance rule shall be made not less than 30 days before its effective date, except -

(1) a substantive rule which grants or recognises an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

§554. Adjudications

(a) This section applies, according to the provisions thereof, in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing, except to the extent that there is involved -

(1) a matter subject to a subsequent trial of the law and the facts de novo in a court;

[rest of (a) omitted]

(b) Persons entitled to notice of an agency hearing shall be timely informed of -

(1) the time, place and nature of the hearing;

(2) the legal authority and jurisdiction under which the hearing is to be held; and

(3) the matters of fact and law asserted.

When private persons are the moving parties, other parties to the proceeding shall give prompt notice of issues controverted in fact or law; and in other instances agencies may by rule require
responsive pleading. In fixing the time and place for hearings, due regard shall be had for the convenience and necessity of the parties or their representatives.

(c) The agency shall give all interested parties opportunity for -

   (1) the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustment when time, the nature of the proceeding, and the public interest permit; and

   (2) to the extent that the parties are unable so to determine a controversy by consent, hearing and decision on notice and in accordance with sections 556 and 557 of this title.

[(d) and (e) omitted]
7. THE SHAPE OF UK ECONOMIC REGULATION

7.1 Introduction

This chapter deals with the existing structure of UK economic regulation. It begins by outlining British experience to date with the use of the agency model in various areas, including the Next Steps initiative in public administration, and goes on to illustrate the use of the agency model as a tool of economic regulation. The emphasis in the chapter is primarily on UK regulatory structures, although the use of agency structures will be illustrated by reference to one Commonwealth example, that of AUSTEL in Australia.

The chapter goes on to examine the contemporary regulatory situation in different areas of the UK economy, including the privatised utilities, the deregulated local bus transport industry, rail and air transport and self regulatory regimes such as that operating in the financial services area. It then discusses the relationship between competition law and structures and economic regulation, including some consideration of the role of the MMC. Last but not least the chapter examines the growing influence of EC membership on UK economic regulation, with particular reference to deregulatory initiatives in EC telecommunications.

The chapter seeks to show the relationship between different regulatory structures and the surrounding governmental and institutional framework with a view to providing a basis for the analysis of economic regulation carried out in this thesis. It also provides the required background for the case studies of UK economic regulation contained in chapter 9.

7.2 Use of the Agency Model to Date in UK Social and Economic Regulation

7.2.1 The Use of Agencies in Social Regulation

The use of the agency model as a regulatory device is certainly not unknown in United Kingdom experience. The field of contemporary social regulation, for example, offers several pertinent examples which merit some examination here. One example is the Gaming Board for Great Britain, established under the Gaming Act 1968 as the agency
with primary responsibility for imposing a relatively detailed regulatory regime in respect of commercial gaming activities. It is noteworthy in the present context that the approach adopted by the Gaming Board has not centred on the promotion of competition between gaming entrepreneurs. Instead the Board has concentrated on adjusting the supply of local gaming facilities in particular areas so that they correlate with the demand in those areas for such services.¹

The Gaming Board is somewhat distinctive in comparison with other regulatory bodies in that its policy-making role is comparatively strictly confined by its empowering legislation and it has no direct mandate to shape the evolution of a United Kingdom market for gaming services. The main thrust of its regulatory activity is in relation to the assessment of the suitability of intending licence holders together with consideration of the need for the proposed gaming facilities in a particular area. The courts have, in practice, been prepared to allow the Board reasonable procedural leeway to date in carrying out its regulatory functions.²

Regulation of commercial gambling in the form of the National Lottery has been undertaken through a new statutory body, the Office of the National Lottery (OFLOT), established under the National Lottery Act 1993.³ The regulator here had extensive involvement both in the choice of operator and in setting the conditions for the operation and control of the lottery. Some aspects of the regulator’s activities in these areas have proved to be not uncontroversial. Mr Peter Davis, the present Director General of the Office of the National Lottery, gained unwanted public and media attention in December 1995 over allegations that he had accepted free hospitality from

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³ For a recent discussion of the regulatory regime established in respect of the National Lottery see Miers, "Regulation and the Public Interest: Commercial Gambling and the National Lottery" (1996) 59 Mod LR 489. In his article, Miers identifies four features which are commonly found in regulatory regimes governing commercial gambling. These are "prior clearance schemes", including quality controls and measures aimed at ensuring the integrity of any tendering process, standard setting in relation to licensed operators, controlling the conditions of player participation and ensuring operator compliance with prescribed licence conditions. (See pp 504-514).
the American lottery operator GTech, which provided technical know-how for the National Lottery. This apparently included the provision of air travel and meals during a visit to the United States in October 1994, a few weeks before the National Lottery was launched.\(^4\)

When the row surfaced publicly, questions were raised about the possibility of capture of single regulators and about the implications of the saga for UK regulation itself.\(^5\)

The controversy deepened when it was revealed a few days later that Mr Davis had in fact ignored advice from government officials given to him in August 1994 shortly before his trip, warning him against accepting free flights or accommodation from the American partner in the lottery consortium.\(^6\)

The Heritage Secretary, Virginia Bottomley sternly rebuked the regulator but he narrowly managed to retain his job,\(^7\) a decision which was thought to be based largely on political considerations and which was criticised in the media.\(^8\)

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4. For a detailed description of the regulator's activities in this context see article in *The Times* of 14 December 1995: "Lottery watchdog kept careful log of controversial trips." A confidential report by Mr Davis to the Public Accounts Committee of the House of Commons was leaked to *The Times* and formed the basis for this article.

5. See for example editorial in *The Times*, 13 December 1995, "Moral Lottery. Both regulation and regulator have futures at stake" which observed: "The greatest danger facing any regulator is what is known as 'capture' by the companies under regulation. Mr Davis's acceptance of air flights from GTech does not inspire confidence that he properly understood either the pressures or his responsibility. // The broad issue raised by this fiasco is the future of regulation itself. The early advocates of privatisation in this country argued that stern regulation would address the fears of those worried that public monopolies would become a licence to print money in private hands. The reality has been messier. In particular, the regulation of the water industry has failed to meet public needs; now the ethics of the National Lottery have been called into question. This is a downward trend which the Government must halt. At stake is more than the fate of a single bid for the lottery."


7. See article in *The Times*, 20 December 1995: "Bottomley gives regulator of lottery a second chance."

8. See article in *The Independent*, 20 December 1995: "Senior Tories earn reprieve for Oflot chief"; article in *The Times*, 20 December 1995: "Bottomley and Davis: A bad decision by both politician and regulator." It is thought unlikely that the present Labour government will reappoint Mr Davis when his contract expires in October 1998. See article in *The Times*, 18 May 1997: "Oflot's Davis is likely to go next year."
This episode gives rise to some disquiet when the use of single industry regulators is considered. In an industry such as commercial gambling, which is notorious in other jurisdictions (not least the United States) for its alleged links with organised crime, the possibility of regulatory capture must be regarded as a cogent one. Where licences to operate lotteries are awarded by a tendering process, the need for regulatory independence is all the more manifest. Just as justice must not only be done, but also be seen to be done, so too the process of regulatory decision making must be carried on with demonstrable independence. Such concerns have been highlighted in the report by the then Labour Opposition on the future of the National Lottery issued in December 1996, which identified the potential for major conflicts of interest under the present regime where OFLOT was responsible for both ensuring the success of the National Lottery and also for representing the consumer interest in this area.9

In other areas of social regulation such as the promotion of racial equality and equal opportunities the agency model has also been adopted. The Commission for Racial Equality (CRE) was established under the Race Relations Act 1976 and the Equal Opportunities Commission (EOC) under the Sex Discrimination Act 1975. Both agencies have been given wide powers in relation to investigations, complaints and the deterring of objectionable behaviour within the scope of their mandate.10

A noteworthy aspect of the operations of many of these agencies concerns their use of codes of practice as a means of furthering the objectives for which they were established, a topic which will be examined in more detail in chapter 8.11 Along with


11. See the discussion of the use of Codes of Practice in parts 8.2.3(i) and (ii) of chapter 8. Such codes have also been popular in the health sector with NHS Boards and with the Mental Health Act Commission. See Cavadino, "Commissions and Codes: A Case Study in Law and Public Administration" [1993] Public Law 333; Belcher, "Codes of Conduct and Accountability for NHS Boards" [1995] Public Law 288.
the Civil Aviation Authority in the economic sphere, the CRE provides what may be the best illustration in the context of social regulation in Britain of an administrative agency structured along US lines. This is particularly evident in the processes of consultation which it undertakes in relation to the issuing of its codes of practice, as will later be seen. Other examples can also be found of the use of agencies in UK social, or mixed social and economic, regulation, such as the Health and Safety Commission, the Independent Television Commission and the Environment Agency recently established under the Environment Act 1995.

7.2.2 The Use of Agencies in Public Administration

The agency model has also found its way into the field of British public administration in terms of recent reforms of the civil service. These were announced by the then Prime Minister, Mrs Thatcher, in February 1988 and consisted of the transferring of some 70,000 positions to new executive agencies pursuant to a progressive hiving-off programme. The proposals originated from a government report of that year, which


13. For a discussion of the work of the ITC see part 9.4 of chapter 9.

14. With effect from 1 April 1996 the Environment Agency assumed responsibility for the environmental protection work previously carried on by the National Rivers Authority, Her Majesty's Inspectorate of Pollution and the various Waste Regulation Authorities. For a discussion of the work of the new agency see Lord de Ramsey, "Industry, development and the role of the New Environment Agency" Legal Times Supplement, 16 October 1995, p 5 and Sykes, "A leaner, meaner, more together Agency?" Legal Times Supplement, 16 October 1995, p 23. (The writer cannot resist observing here that while a modern reader is inclined to treat environmental concerns as a recent phenomenon this is not necessarily the case. John Evelyn, in his book, Fumifugium: or the Inconvenience of the Aer and Smoke of London Dissipated (London, 1661) proposed to eliminate the 'Hellish and dismal Cloud of Sea-Coal' which then enveloped London by banishing smoke producing trades from the city limits and planting large numbers of 'fragrant and odoriferous' trees, noting that the air of London had never been cleaner than in the year when the Dutch fleet blockaded Newcastle-on-Tyne, preventing the shipping of coal to the capital!)

criticised levels of management performance within the civil service and highlighted certain structural difficulties. These included the apparent preoccupation of senior civil servants with responding to the concerns of Ministers at the expense of paying attention to internal departmental management, leading to difficulties in supervision and inefficiency within departments. The report concluded that since a great deal of civil service work concerned delivery of services rather than the making of policy much of the work involved could be carried out by separate agencies, leaving a considerably reduced core of staff civil servants to provide required policy advice to Ministers.

In practical terms the government accepted that the executive functions of the civil service should be performed by agencies as far as possible. These were to be under the control of Chief Executives who would take responsibility for internal management and for implementing the policy of the agency. A progressive programme to implement this structure was to be adopted and staff were to be trained in the new regime, with an overall project manager to be appointed to oversee the initiative. Next Steps agencies have now been established in a number of areas, including agencies which are responsible to the respective Secretary of State for the Environment, the Department of Social Security, the Customs and Excise Department and the Department of Employment.

The Next Steps initiative has had both political and constitutional implications. At the political level the initiative was seen as being intended to weaken the power of the civil service unions, perhaps with a view to easing the path for further privatisations. At the constitutional level the programme had discernible implications for the doctrine of Ministerial responsibility, in that the heads of the executive agencies were to operate under authority delegated from the appropriate Minister and within the framework of


policy directives set by the Minister. Whether this changed system of accountability is desirable as a matter of constitutional practice continues to be hotly debated by academic commentators.\(^{18}\) Drewry, for example, has taken a particularly sceptical view of the political motivations underlying the programme.\(^ {19}\)

This concern with the accountability of agencies is one which does of course have wider application than in the context of public administration. In the case of the Next Steps agencies, it is clear that some degree of departmental monitoring might be required if previously existing standards of accountability were to remain applicable under the new arrangements. This could lead to the possibility of having parallel systems of administration within a department and an agency with accompanying difficulties of co-ordination and the possibility of inefficiency and duplication of roles.\(^ {20}\) Some commentators, like Dudley, have taken a more pessimistic view, from a political science perspective, of the possibility of the Next Steps agencies performing any better in the field of public administration than the post-war public corporations did as a means of implementing public ownership.\(^ {21}\)

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19. Drewry, "Next Steps: The Pace Falters", ibid, at 327-328, who expresses the view that: "Parliamentary scrutiny tends too often to be seen by government, not as an ally of good administration and value for money but as something that gets in the way. The implicit rationale (or possibly an unintended consequence) of Next Steps is to weaken an already weak mechanism of ministerial responsibility to Parliament, by creating a series of arm's length relationships between ministers and the deliverers of public services - and to do so without at the same time introducing other controls, such as a much stronger system of administrative law."

20. For a fuller discussion of this point see Baldwin, supra note 16, at pp 625-626.

21. Dudley, "The Next Steps Agencies, Political Salience and the Arm's-Length Principle: Barbara Castle at the Ministry of Transport 1965-68" [1994] Pub Admin 219 at 239: "It is a peculiar irony of UK public administration that, as the public corporations are killed off, so the arm's-length principle should be resurrected in another form. There are also similarities in official perceptions in that, just as the public corporations were seen as a great 20th century solution to the problem of separating political and administrative management of the nationalised industries, so the Next Steps agencies are viewed as offering a twenty-first century model which encourages managerial discretion while retaining overall policy control. Ultimately, the public corporations could not bear the weight of expectations placed upon them. Similarly, it must be doubted if agencies which possess inherently high potential political salience can discover the philosopher's stone of simultaneously marrying and separating political and administrative control." In this article Dudley looked at the diaries of Barbara Castle during her period as Transport Minister from 1965-68 as part of an analysis of the factors determining ministerial behaviour. In comparing that period with the current phenomenon of Next Steps agencies, his conclusion was that direct ministerial control was preferable to the arm's length principle.
Other difficulties have also become evident in the Next Steps model, such as the unclear contractual capacity and status of the agencies themselves, coupled with foreseeable difficulties with appointment of staff, both in terms of possible political patronage and the effect of the programme on public service career structures in general. There is also the problem of defining the respective roles and responsibilities of Ministers and Agency heads. The dismissal by the then Home Secretary, Mr Howard, of the head of the Prison Service, Mr Derek Lewis, during October 1995 on the basis of an alleged failure to implement appropriate internal procedures to prevent prison escapes such as those from Parkhurst Prison, and the response from Mr Lewis that his hands had been tied by the terms of the Framework document constituting the service as a separate agency, provide recent confirmation that these difficulties are far from being merely hypothetical in nature.

Many of these areas of difficulty arise out of the fact that the agencies have been called upon to perform functions at the political level which were previously within the mandate of the civil service, leading to confusion between the policy and accountability areas. These problems may not necessarily arise in quite the same way in the context of external economic regulation, where independence of action within the framework of a legislative mandate is the primary characteristic. Nevertheless the Next Steps experience reminds us that achieving successful administration through the medium of an agency framework is not something to be taken for granted. The same can be said for the use of external agencies for the purposes of economic regulation.

Finally, on the subject of public administration and the Next Steps initiative, it is clear that concerns with ministerial responsibility and accountability remain live issues in this context. These are matters which will also concern us when we come to examine the role of regulatory agencies, which have a similar structural basis. The essential

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23. On these points see Craig, supra note 22, pp 87-88, and Drewry, "Next Steps: The Pace Falters", supra note 18, at pp 328-329.

24. For a discussion of the circumstances of, and issues arising from, the dismissal of Mr Lewis see Fox and Hunter, "Yes, Minister; No, Minister!" Law Society's Gazette, 1 November 1995, p 16.
problem here has been succinctly summarised by Craig,\textsuperscript{25} who has noted the historical parallels with the 19th century in this area.

The above analysis serves to demonstrate the pervasive nature of the agency structure, both as a means of social and economic regulation and also as the preferred vehicle for modern public administration in the United Kingdom. Despite this, the agency model has not been the one chosen for the regulation of the privatised utilities and passenger rail transport, though the model chosen may not actually be all that much different in practice, nor (at least in the form of a single, responsible entity) in relation to the self-regulatory regime established in relation to financial services.

7.3 A Commonwealth Case Study - Agency Regulation in Australian Telecommunications

7.3.1 The Structure and Functions of AUSTEL

While this chapter is primarily concerned with UK regulatory structures, it is useful at this stage to digress slightly by examining a Commonwealth example. The reason for this is that UK experience with the use of agency structures in economic regulation is more limited than in some Commonwealth jurisdictions and the example to be discussed, that of AUSTEL in Australia, illustrates the role of agencies in regulating competition in a particular industry by a variety of techniques.

Until 1 July 1997, AUSTEL was the body responsible for the regulation of the Australian telecommunications industry. This sector has recently undergone radical structural changes. After a long period in which Telecom Australia was the dominant market entity, a structure for the reform of the industry was put in place under the

\textsuperscript{25} Craig, \textit{supra} note 22, at p 89: "It is in the realm of \textit{traditional accountability} that most public disquiet has been focused. The discussion of the administrative machinery in the nineteenth century revealed the strains placed on the Board system by the growing desire of Parliament to have a person directly answerable in the House for its activities. The resurgence and expansion of agencies has raised this same problem in a more acute form, since we are now accustomed to the idea of ministerial responsibility as the 'constitutional norm'." See also Giddings, \textit{supra} note 17, chapter 12 and Drewry, \textit{supra} note 17, pp 169-170, who notes at p 169 that: "The principal constitutional question marks surrounding Next Steps and related initiatives have to do with accountability. Is Next Steps really compatible with the traditional principles of ministerial responsibility that the government has insisted will remain intact?"
Telecommunications Act 1991, which has in turn recently been replaced by new legislation. The 1991 Act provided for regulated competition between two major telecommunications companies, Telecom Australia and Australian and Overseas Telecommunications Corporation (AOTC), together with a third company, AUSSAT, which was licensed to provide mobile telecommunications services to the public. These arrangements were transitional in nature and full competition in the Australian telecommunications industry is being progressively introduced, along with a comprehensive new legislative framework.26

The background to the 1991 Australian legislation was one of increasing concern with the performance of Telecom Australia in areas such as prices, productivity, service performance, research and development and organisational costs.27 The new industry structure permitted competition between the two major market players, to be followed by full industry competition from 1 July 1997 (which has now occurred).

There were also provisions designed to ensure the full resale of telecommunications services and the provision of universal service and other obligations of a consumer nature by the industry participants. Obligations to consumers could be imposed on carriers either under the Act or by means of licence conditions. The 1991 Act itself, in s 73, imposed a standard licence condition requiring a licensee to provide an untimed local telephone call option to residential customers and to charitable and welfare organisations.

The structure which was chosen to promote these objectives was a regulatory agency designed specifically for the telecommunications industry, known as AUSTEL. The regulator's functions were detailed in the 1991 legislation and included promoting competition, protecting the interest of consumers, managing the numbering of


27. See Fanning, ibid, pp 30-32.
telecommunications services, reporting to the Minister on the implementation of the legislation and dealing with licensing and technical matters.

The regulator was an independent statutory body consisting of a chairman and two other members and a staff of about 140 divided into three divisions. These were a technical standards division, a commercial division and a secretariat division. The staff members were members of the Australian civil service. AUSTEL had broad powers to issue directions to operators. These directions, together with the observance of licence conditions by operators, could be enforced by the Minister by action in the Australian Federal Court. Where a licensee failed to comply with a direction which had been given to it by the regulator, any person suffering loss as a result of that non-compliance could seek damages against the licensee in the Federal Court under s 353. The Act therefore provided for a limited right of private enforcement in this respect.28 (This was a development which might profitably be introduced in Britain, as will be discussed in chapters 9 and 11.) It was envisaged that as the industry moved into its fully competitive phase, the interventionist role of the regulator would decrease in significance.29

Two other features of the Australian telecommunications regulatory regime established under the 1991 Act were noteworthy. The first was the statutory power given to AUSTEL allowing it to set conditions of interconnection for industry carriers. The Act provided that industry participants were to carry out initial negotiations as to the basis for interconnection to the telecommunications network. In the event of disagreement the regulator could intervene and conduct a final and binding arbitration between the

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29. Leonard and Waters "Regulating for Competition: The Telecommunications Act 1991" in Corones (ed), supra note 26, p 73 at p 74: "Accordingly, industry-specific competition regulation is seen by the Government as primarily a transitional measure, required only to the extent that telecommunications carriers in nascent competitive markets may be able to adopt policies and practices that are in their own economic interest but contrary to the interest of consumers. The economic rationalist approach adopted by the Government includes that where effective and sustainable competition is established, each competitor's economic interests will equate with the public interest, by driving each competitor to market those products and services in which it is relatively efficient compared to its competitors, and protecting consumer interests by forcing firms to set prices on the basis of their costs."
parties. The principles relating to the charging regime for interconnection or access could be determined by the Minister prior to any such discussion or arbitration.\textsuperscript{30}

The second significant aspect of the legislation was that a Code of Practice in relation to dealings by carriers with international telecommunications operators could be implemented by Ministerial determination and imposed on industry participants. Such codes were binding on telecommunications licensees and were enforceable by the regulator.\textsuperscript{31}

AUSTEL’s policies over interconnection and pricing issues have already been the subject of considerable interest within the Australian academic community.\textsuperscript{32} These studies noted that pricing behaviour in the Australian telecommunications market was likely to become increasingly aggressive as competition continued to grow, which would in turn place pressure on Telecom in respect of its pricing schedules. The approach which AUSTEL had adopted towards the control of price discrimination and its general approach to tariff review issues have, however, been the subject of particular criticism in the literature. Henry Ergas, one of the leading commentators in this area, was particularly critical of AUSTEL’s policies in these areas.\textsuperscript{33}


\textsuperscript{31} Telecommunications Act 1991 (Aust.), ss 55, 63, 77-79.


\textsuperscript{33} Ergas, \textit{The Control of Price Discrimination in Australian Telecommunications: A Critical Review}, ibid, p 32: "AUSTEL takes the view that the tests it proposes are required by the tight deadlines to which it must operate. However, other agencies also operate subject to time constraints; and this does not lead them to adopt tests which are at best poorly thought through and - to the extent to which they can be interpreted - are broadly inimical to economic efficiency. Each part of the tests AUSTEL has devised seems to be flawed; taken as a whole they seem far from being consistent with the broad goals of the liberalisation process."
The granting of power to the regulator to enforce terms and conditions of interconnection would nevertheless seem to be a sensible provision, particularly in the light of the difficulties encountered in the New Zealand telecommunications market in this area, which have been described in more detail in part 4.6.2 of chapter 4. Leonard and Waters have noted the contrasting approach between the two jurisdictions in this area.34

The Australian regulatory regime in the telecommunications area under the 1991 legislation adopted an agency structure and a legislative scheme which bore some resemblance to that under which OFTEL operates in the United Kingdom context, involving licensing of individual operators and the possibility of using statutory powers to act in the interests of consumers. Similarly, the recent opening up of the Australian telecommunications market to free competition as a matter of express government policy has also mirrored corresponding initiatives in the UK telecommunications area.

As noted above, the 1991 Australian legislation allowed the use of Codes of Practice within a relatively limited area, and subject to relatively close control on the part of the responsible Minister. While the Australian federal constitutional emphasis on responsible government may serve to explain the restrictions on industry rule-making which are evident in this context such arguments are not necessarily as cogent in a unitary jurisdiction such as the United Kingdom. This should afford greater opportunity for the use of discretionary techniques of regulatory enforcement in the United Kingdom, an aspect which will be examined further in chapter 9.

7.3.2 Issues of Institutional Design in Economic Regulation

Issues of institutional design in the context of Australian telecommunications regulation have also attracted some academic scrutiny, which has afforded some insights into this area which might be of more general application. Again, some of the

34. See Leonard and Waters, supra note 29 at p 109: "This approach stands in stark contrast to that adopted in New Zealand, where the Government has essentially left telecommunications regulation to the (generalist) Commerce Commission and the courts apply the general trade practices provisions of the Commerce Act 1986. In this sense, Australia and New Zealand are currently engaged in testing two starkly different approaches to telecommunications regulation. The results to date of the New Zealand approach are not promising."
most intensive work to date in this area has been carried out by Ergas, who has compared the merits of various regulatory structures, including Ministerial direction, use of courts and tribunals and regulatory agencies.35 Ergas considered that the most significant feature in the modern analysis of institutional alternatives in regulation is represented by the concept of permeability. By this, he meant the extent to which each form of regulation was open to external influence or participation. Ergas took the view that Ministerial decision-making is the least constrained, being particularly susceptible to outside influences.36

Shorn of its socio-economic jargon, Ergas is essentially restating the maxims of public choice theory applied to the political arena. His theory basically postulates that Ministers, as political creatures, will seek to use their decision-making power to the greatest political advantage. This is likely to result in gains to powerful commercial interests who can exert considerable political influence (including natural monopolists or near-monopolists), while simultaneously disadvantaging those with limited access to the political process. On the other hand Ministerial decision-making, being frequently ad hoc in nature, may in fact prove to be sufficiently flexible to achieve a real improvement in the areas sought. However its inherent instability can also give rise to an undesirable degree of institutional unpredictability, which might outweigh these advantages.

At the other regulatory extreme, Ergas theorises that courts and tribunals are "substantially less vulnerable to these forms of manipulation".37 Here there is limited scope for external influences to be brought to bear, or for other forms of rent-seeking (or self-interested) behaviour.


36. Ibid p 9: "... this type of decision-making [by Ministers] is most likely to fail when the gains associated with a policy are concentrated while the costs it imposes are diffuse. The potential gainers can then organise to exert the maximum influence on the taking and implementing of decisions - through threats and inducements, by distorting the information they provide, and (in coalition with the Minister) by making it difficult for those who are losing out to realise the costs which are being imposed on them. However, Ministerial decision-making is also relatively unstable. This has some obvious advantages in allowing scope for iterating towards better public policy - for example, by incorporating new information and/or accommodating changing community values. From the point of view of interested parties, however, the threat of future changes must reduce the value of any gains currently secured."
However, there are also accompanying limitations on the use of judicial processes as a regulatory tool. The most serious of these is the need for a justiciable dispute to arise (a limitation which does not inhibit a regulatory body invested with wider investigatory and adjudicative powers). There is often also accompanying cost and complexity (and sometimes considerable delay in reaching the hearing stage of the process) and limited independent investigative powers (in that courts in common law, as opposed to inquisitorial, systems are generally restricted to adjudicating on issues raised by counsel and cannot normally undertake wider research or definition of issues on their own initiative). Finally there is the fact that court-based adjudication is limited in its application to the parties in question and may have a minimal effect on future conduct on the part of others. (Such an objection does, however, tend to underestimate the fact that in a common law system court rulings frequently have a tangible precedent value in terms of future cases.)

Ergas sees regulatory agencies as occupying an intermediate position between these two extremes. On the other hand, he recognises that the use of agencies as a regulatory tool can also have disadvantages. There may be a lesser degree of scrutiny, especially in the case of an industry-specific agency and such an agency may come to be used as a political football by politicians intent on enhancing the value of politically motivated decisions. There may also be problems of accountability (which Ergas refers to as "goal displacement") and the redistributive function of a regulatory regime may not match the intention of the underlying legislation in any particular area.

7.3.3 Resolution of Interconnection Disputes in Australia

Applying his theory to the problem of regulating interconnection in Australian telecommunications, Ergas noted the legislative reliance under the 1991 Act on both

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38. Ibid p 10: "More explicitly set out functions and more formalised procedures for determining standing, assessing the admissibility of evidence and justifying the decisions taken, reduce vulnerability to rent-seeking, as do rules limiting ex parte consultations. The agencies are also generally able to call on in-house expertise, enhancing the scope for pro-active rule-making and enforcement. At the same time, the agencies typically retain the powers of initiative needed to address issues on an ex ante basis and to resort to policy incrementalism as a response to uncertainty."
Ministerial directions and on AUSTEL. According to him, AUSTEL had (improperly) used its autonomous regulatory position to bring about certain alterations in the regulatory regime, particularly in relation to resellers of transmission capacity. In his view different institutions exhibited varying degrees of vulnerability to interest group pressures.³⁹

It is interesting to note that Ergas seems to be effectively advocating a system of light-handed regulation along the lines of that adopted in New Zealand. However, his theory does not explain how regulation accompanied by a lesser degree of oversight by an industry-specific body (such as AUSTEL) might serve to overcome an unwillingness on the part of an incumbent monopolist to enter into meaningful negotiations on issues such as the terms of interconnection. Unless the general competition law contains sufficient powers to enforce participation in this way, there may well be no effective means of compelling an incumbent monopolist to make its existing transmission or service network available to a prospective market entrant, which is one of the aims of modern competition law. Nevertheless, as was noted in chapter 4, the Australian approach has been to transfer responsibility for significant competition issues in telecommunications to the recently restructured competition authorities.⁴⁰

In that chapter there was some discussion of the Hilmer Report and its influence on the direction of contemporary Australian competition law.⁴¹ The Hilmer Committee had expressed the view that the key network industries exhibited sufficient common features to justify regulation on a unified basis through one regulatory body. This would not only entail administrative savings but would also provide a unified approach from a national perspective, ensuring that regulatory expertise and experience derived from one industry could be applied to other sectors. The Committee concluded that

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³⁹. *Ibid* p 13: "The institutions through which policies are made and implemented can be analysed in terms of their institutional capability and of their vulnerability to rent-seeking. Ministerial decision-making tends to be the most vulnerable to manipulation by concentrated interests. Industry-specific regulators have a greater degree of autonomy, but frequently serve to add credibility to the special bargains made by Ministers. Though courts tend to be less vulnerable to rent-seeking than the other institutions of public governance, there are severe limits on their capabilities. This suggests reliance on institutions which are subject to effective surveillance by broad interest coalitions, as is typically the case with national competition policy authorities."

⁴⁰. See part 4.6.5 of chapter 4.

these advantages might not occur if regulation was to be carried on through industry-specific bodies.

Such a regime would serve to obviate difficulties such as failure to agree on interconnection in the telecommunications context and would help to avoid some of the problems encountered in the New Zealand telecommunications industry. The recommendations in the Report have been the subject of critical analysis by commentators such as Pengilley and others. Pengilley supported some of the Committee's recommendations (including the need for an adjudicative mechanism) but was strongly opposed to others (especially the Report's approach that a right of access to essential facilities was an issue which involved significant public interest considerations.) In his view, access questions solely involve issues of competition law which primarily affected only the parties to the dispute.⁴²

Such a view, while it might be expected from a leading Australian competition lawyer with an extensive corporate practice in this area, tends to underrate what can reasonably be regarded as a legitimate interest on the part of the public in participating in decisions on access issues where essential facilities are involved. An ideal regulatory regime should allow adequate scope for participation by public interest groups in the process of regulatory decision-making, a matter which will be canvassed in more detail in subsequent chapters.

Steps have already been taken to implement the Hilmer Report in Australia. The Competition Policy Reform Act 1995 was passed by the Australian federal Parliament and received the Royal Assent on 30 July 1995. This Act extended the prohibitions on anti-competitive conduct and misuse of market power contained in the existing Australian Trade Practices Act 1974. It also inserted a new access regime into the Trade Practices Act 1974 (as a new Part IIIA) which took effect from 7 November 1995. The legislation (which has proved to be controversial in some areas) had a wide ambit, and professional groups (including the legal profession) came within its ambit.⁴³

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⁴² See Pengilley, "Hilmer and 'Essential Facilities' " (1994) 17 UNSWLJ 1 at 32-49.

In the telecommunications area specialised legislation governing anti-competitive conduct has recently been adopted in the form of the Trade Practices Amendment (Telecommunications) Act 1996, which came into force on 1 July 1997.

The access regime which has been adopted in Australia is based on the provisions of the Hilmer Report and encourages inter-party negotiation as the preferred medium for resolution of interconnection issues. If this avenue proves unsuccessful then a market entrant can apply to the National Competition Council (NCC) for a declaration as to whether the network in question should be declared to be an essential facility. The NCC bases its decision on a range of statutory criteria (including whether the provision of access to the facility would promote competition, whether it would be uneconomic to develop another facility of the same kind and whether the facility is of national significance.) It then makes a recommendation to the designated Minister who must issue a reasoned decision as to whether a facility should be declared. There is then a right to apply to the Australian Competition Tribunal for review of the Minister's decision within 21 days after the decision has been published.

Once the facility has been declared access terms can be negotiated and in the absence of agreement the Australian Competition and Consumer Commission (ACCC) has power to arbitrate on the access dispute, on the basis of a number of statutory criteria. The


45. See Trade Practices Act 1974 (Aust), s 44G(1) and (2); Halsbury's Laws of Australia, supra note 43, para 420-559.

46. Ibid s 44H; para 420-570.

47. Ibid s 44K, para 420-580.

48. Ibid s 44X; para 420-647. These criteria include taking into account the legitimate business needs of the facility provider, the public interest, the cost of providing access, the interests of existing users, and the need to ensure the safe, reliable and economically efficient operation of the facility. The ACCC has stated that it will only invoke the arbitration procedure after commercial negotiations between the parties have failed to produce agreement. Pricing of access and interconnection services is to be based on "total service long-run incremental cost" (TSLRIC) of providing the service. These principles are contained in a publication entitled Access Pricing Principles (ACCC, February 1997), text on the internet at http://www.accc.gov.au/docs/online.htm.
decision of the ACCC can be the subject of a review by the Australian Competition Tribunal, with a further right of appeal to the Federal Court on matters of law. The Commission is given extensive powers to regulate its own procedure and to give all directions as will lead to the speedy hearing and determination of the access dispute. It can make a confidentiality order in respect of certain evidence and information in appropriate circumstances.

The Australian access regime generally can be criticised as being unduly cumbersome and bureaucratic, involving as it does the two stage process of declaration of a facility and later arbitration in the event of disagreement, with the possibility of a review by the ACT and a subsequent appeal to the Federal Court at each stage. This contrasts with the more streamlined New Zealand proposals, which involve one arbitration and a single right of appeal to the court on matters of law. It will be of interest to observe whether dominant firms seek to exploit the complexities of the Australian regime and if so how long the whole process is likely to take.

It is quite conceivable that to run the full procedural course under the Australian legislation could take a minimum of two to three years and possibly longer, so that the legislative scheme may prove to be only marginally more efficient in practice than its judicial counterpart in the New Zealand telecommunications sector to date. However the Australian regime, regardless of whether it proves a boon to competition lawyers, does illustrate the scope for involvement of general competition law bodies in regulatory matters given a supportive legislative framework.

7.4 Regulation of the Privatised Utilities

7.4.1 Introduction

Chapter 2 discussed the way in which both common law and statute had treated the concept of a public utility by way of analogy with the principles relating to other forms

49. Ibid s 44ZP; para 420-690.
50. Ibid s 44ZR; para 420-700.
51. Ibid ss 44ZD to ZJ; paras 420-630 - 420-635.
of monopoly. This part of the chapter examines the regulatory regime which has been put in place in relation to the privatised utilities, being telecommunications, gas, electricity and water. The United Kingdom regime, which is based upon ostensibly independent individual regulators appointed in respect of each particular industry and governed by separate legislation in each case, has a number of unique features and differs in significant ways from the corresponding regulatory system in force in the United States.

As was described in chapter 2, public utilities gradually evolved during the 19th century in terms of their structure and ownership. Over the course of that century municipal ownership gave way to progressively public ownership involving the State, so that by the first decade of the present century a substantial part of the gas, water, electricity and emerging telecommunications industries were the subject of state ownership.

With the exception of the Electricity Commission and the Railway Rates Tribunal of 1921 (which superseded the Railway and Canal Commission established in 1888) the use of commissions or other forms of tribunal did not prove to be popular in Britain in the first half of the present century as compared with US experience. Sleeman, writing in 1953, explained the reasons for this situation in terms of the differing constitutional structures of the two jurisdictions.

This situation continued under the post-war era of nationalisation when state ownership, exercised through the agency of the public corporations, obviated the need for individual industry regulation. This situation prompted Sleeman to remark that regulatory activity in relation to public utilities in Britain was likely to remain limited in


53. Sleeman, ibid, p 45: "Less use has been made in Britain than in such countries as the United States of the device of regulatory commissions or tribunals. The reason for this is probably twofold. The need to obtain specific statutory powers for most utility undertakings made possible the imposing of effective conditions at the beginning of operations, while the absence of constitutional limitations such as those contained in the American federal system made possible the exercise of stronger regulatory powers by the Government Departments."
As the above passage illustrates, the making of such predictions can often be hazardous, albeit that in Sleeman's case his forecast remained true for some 40 years.

7.4.2 Telecommunications

(i) Origins of the Regulatory Regime

The era of privatisation in the 1980s gave rise to a perceived need to provide a suitable regulatory regime in relation to the public sector monopolies, given the circumstances surrounding their transition from public to private ownership. In the UK the telephone system has been publicly owned and operated for much of the present century. The telecommunications industry, for example, witnessed the introduction of a minimal degree of competition on privatisation, with British Telecom's monopoly becoming a

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54. *Ibid*, p 47: "On the whole, therefore, British experience suggests that it is unlikely that there will be an extension of the use of tribunals as a means of promoting the efficiency of large-scale monopoly undertakings."

55. For an historical survey of public ownership of telecommunications in the UK see Meyer, *Public Ownership and the Telephone in Great Britain* (The Macmillan Company, London & NY, 1907). Briefly, the British government acquired a monopoly over the telegraph business in 1869. The telephone emerged as a viable invention several years later in 1876-1877 but at that time the government was reluctant to acquire the patents to the invention. An initial period of competition between the state telegraph system and the privately owned Edison Telephone Company ensued, leading to litigation concerning the extent to which telephone services infringed the Postmaster General's monopoly on telegraphic transmissions. In a celebrated decision given in 1880 in the case of *The Attorney-General v The Edison Telephone Company of London Limited* (1880) LR 6 QBD 244, the Exchequer Division held that the Edison Company's patented telephone constituted a "telegraph" within the meaning of the Telegraph Act 1869 and that telephone conversations amounted to "telegrams" within the meaning of the legislation. The telephone therefore infringed the Postmaster General's exclusive privilege over telegraphic transmissions and an injunction was issued restraining the carrying on of private telephone services. An appeal was lodged by the Edison Company but in return for abandoning the appeal the Postmaster General agreed to grant the company a licence to establish and operate telephone exchanges. However the Postmaster General reserved the right to operate his own exchanges and to grant licences to other telephone companies. In the late 19th century consolidation of the industry occurred and the National Telephone Company was formed. Various government inquiries into the industry were subsequently held. Private ownership in various forms continued until the Post Office acquired a monopoly over all UK telecommunications services in 1912. The General Post Office was reconstituted as a statutory corporation under the Post Office Act 1969. It was subsequently divided into two separate entities, British Post and British Telecom, under the Telecommunications Act 1981. These developments were the prelude to the liberalisation of the industry which occurred during the 1980s.
duopoly, following the entry into the market of Mercury Communications Limited as a second licensee.56

This situation had the potential for obvious adverse consequences in terms of market distortions and damage to the consumer interest if an adequate regulatory regime was not put in place. The telecommunications industry provided the test case for a form of external regulation in the public utility context. Under the Telecommunications Act 1984 all telecommunications operators were required to be licensed. The Act provided for the establishment of the position of Director-General of Telecommunications, who was to be appointed by the Secretary of State and was to be in charge of the Office of Telecommunications (OFTEL). This office was modelled to some extent on the Office of Fair Trading but its responsibilities were restricted to the telecommunications industry.

The first Director General was Professor Bryan Carsberg, a professor of accountancy at the London School of Economics & Political Science, who headed a staff of about 80. (This number had increased to 160 by May 1995.) British Telecom was granted several licences under the 1984 Act, the principal one being in respect of its public telephone network operations. Mercury Communications Limited had previously been granted a network licence in February 1982 and was granted a new licence under the 1984 Act. This licence was similar in many ways to the licence granted to British Telecom, but did not contain provisions relating to the provision of service to the public or price capping.

(ii) A Brief History of OFTEL's Regulatory Activities

The Telecommunications Act 1984 came into force on 5 August 1984. OFTEL was established shortly before this legislation came into force and the first Director General was appointed for a three year period commencing on 1 July 1984. In his first annual

56. For a general description of the liberalisation of the UK telecommunications industry during the early part of the 1980s see Beesley (ed), Privatisation, Regulation and Deregulation (IEA, London, 1992), chapters 12-14. The regulatory issues arising out of the duopoly situation are discussed in Kruessmann, "Breaking up is hard to do: the regulator's mandate to increase competition in telecommunications and gas" (1993) 4 Util LR 203.
report, the Director General summarised his responsibilities and noted that his regulatory responsibilities were focused on protecting the consumer interest.57

In the first five months of its existence OFTEL dealt with some 300 complaints and inquiries, most of which related to British Telecom (BT).58 These mainly concerned queries about licence provisions and BT's pricing policies and complaints about charges, tariffs and the ownership and supply of wiring and telephone apparatus. The issue of interconnection between Mercury and BT raised its head at an early stage and the regulator noted that agreement on this issue had not been reached as at the date of his first report.59 OFTEL recognised that ensuring effective competition in the industry was the most effective way of safeguarding the consumer interest. It therefore initiated extensive consultation with BT in relation to preparation of a consumer code of practice, the adoption of which was a condition of BT's licence. The regulatory activities of OFTEL progressively increased in intensity over the next few years.60

BT's monopoly on pay phones ended in May 1988 and in July of that year a new price cap of RPI - 4.5% was agreed with BT for the period from 1 August 1989 to 31 July

57. See Report of the Director General of Telecommunications for the period 5 August to 31 December 1984 to the Secretary of State for Trade and Industry (HC 457, 1984-85, HMSO, London, 3 July 1985) at para 1.4: "The key focus of my duties is to promote the interests of the consumers of telecommunication services and the users of apparatus. In some cases, the effect of my activities on consumers is clear and direct, as when I am investigating a complaint about a service provided to them. In other cases, however, the effect is indirect. I am required to promote competition because this is an important means - in many cases the best available means - of bringing benefits to consumers: competition provides an incentive to charge a fair price, related to the costs of supplying apparatus or providing a service; and competition provides a stronger incentive to use innovative technology in providing new kinds of services - for experience shows that the richest rewards often go to those who use their ingenuity to provide an innovative service at a reasonable price."

58. Ibid para 3.3.

59. Ibid para 3.8: "OFTEL was concerned with the important question of the terms on which the individual licensees would provide interconnection with other networks. This was especially important in the case of BT and Mercury who are the only PTOs likely to be in direct competition nationally across the whole range of services in the foreseeable future. It was a matter of regret that in discussions up to the end of the year the two parties had failed to reach agreement."

60. For a concise summary of the main features of OFTEL's regulatory activities from 1984 to the present, see A Brief History of Recent UK Telecoms and OFTEL (OFTEL Publication, 1996, text on the internet at web site page http://www.oftel.gov.uk/history.htm). During 1996, for example, OFTEL issued some 37 papers, policy statements and consultative documents, details of which can be found on the OFTEL home page on the internet at web site http://www.oftel.gov.uk.
1993. 1989 witnessed the introduction of controls over chatline services and the award of three personal communications network licences.

In November 1990 a review of the duopoly agreement was commenced by the Department of Trade and Industry with a view to examining the BT/Mercury duopoly arrangements which expired that month. A White Paper detailing arrangements for ending the duopoly arrangement was issued by the Department of Trade and Industry in March 1991.61

During 1992 the Director General proposed a new price control formula, set at RPI - 7.5%, with effect from 1 August 1993. BT agreed to this formula in August 1992 in respect of the period to 31 July 1997.62 BT's licence was amended accordingly in March 1993 and the new formula took effect as scheduled in August of that year. In December 1993 the BT/Mercury interconnection determination was published by OFTEL.

Licences were issued to a number of new entrants during 1994, including Sprint, Telstra and WorldCom International in March and Orange in April. In December 1994 OFTEL published a significant consultation document which addressed a range of issues concerning the competitive structure of the industry and the evolution of regulatory oversight.63

During March 1995 BT accepted some significant modifications to its licence in the areas of accounting separation and the setting of standard interconnection charges. A major policy statement on developments in the industry in relation to a competitive market place was issued in July 1995.64 BT's first financial accounts in the required separated form were published in September 1995 and another significant consultative document discussing the pricing of telecommunications services was issued in


62. For a general description of OFTEL's regulatory activities to the end of 1992 see Wigglesworth and Barnes, "UK policies and regulations" (1992) 16 Tel Pol 721.


December 1995.\(^65\) That month also saw the publication by the Director General of his proposals for a fair trading condition to be inserted in telecommunications licences.

The most significant developments during 1996 revolved around the price control review and the adoption of a fair trading condition. Both of these initiatives were accepted in principle by BT's board in August 1996 and the appropriate amendments were formally announced by OFTEL in October 1996.\(^66\) In a decision given on 20 December 1996 the High Court confirmed the legality of the fair trading condition which had been inserted into BT's licence,\(^67\) a decision against which BT did not appeal.

During the first few months of 1997 the telecommunications market has undergone considerable deregulatory activity. Licences were issued to 46 prospective market entrants in November 1996, including a number of US and European companies.\(^68\) A significant international agreement aimed at deregulating global telecommunications markets was signed in Geneva by some 68 countries in February 1997.\(^69\) The effect of these developments has been predicted to be a liberalisation of the industry worldwide, with resultant benefits to the consumer and the creation of a large number of new jobs.\(^70\) Meanwhile, in the UK context, OFTEL demonstrated in March 1997 that its regulatory regime still had teeth by ordering BT to abandon an advertising campaign

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66. For a discussion of these events see part 9.6.11 of chapter 9. For a description of OFTEL's regulatory activities during 1996 see "Telecommunications" (1996) 7 Util LR 44-53, dealing with a range of OFTEL initiatives in different parts of the telecommunications industry.

67. For a discussion of this decision see part 9.6.11 of chapter 9.

68. See article in the *Financial Times*, 13 November 1996: "Telecoms: Britain set to shake up international market".

69. See article in *The Times*, 17 February 1997: "Telecoms pact signals end of monopolies".

70. There are some indications that such benefits are becoming evident already. See for example, article in *The Times*, 15 January 1997, "BT cuts overseas call costs again", reporting that from 19 February 1997 BT would be reducing the costs of making overseas calls to 33 countries by between 10 and 37 per cent.
based on offering significant discounts to former customers with the aim of enticing
them to leave new operators and return to BT.\textsuperscript{71}

The progressive incorporation of the new fair trading condition into the licences of
other operators should result in a more flexible regulatory regime becoming evident.
This should enable the regulator to respond to the challenges of the telecommunications
industry as it moves forward into a new deregulated era. While BT now faces
extensive competition from other operators, whether this will diminish the need for
regulatory intervention in the longer term, or merely cause regulatory attention to be
refocused on specific areas of difficulty, remains to be seen. The OFTEL regulatory
regime has been commendably progressive in terms of its emphasis on consultation and
participation and in its innovative approach to issues of regulatory discretion, as will be
discussed further in chapter 9.

7.4.3 Gas

(i) Gas Industry Regulation 1986 - 1991

The regulatory regime for telecommunications provided a precedent for the gas
industry, which was privatised in 1986. The Office of Gas Supply (OFGAS) was
established under the Gas Act 1986 as the industry regulatory body, in a similar fashion
to OFTEL. However, unlike the position with telecommunications, British Gas was
privatised with its monopoly position basically preserved, a situation which continued
until quite recently.

While it would have been possible (albeit with some difficulty and delay) to have
subdivided the company into independent regional gas distribution companies,
operating in conjunction with a national gas transmission company, this option was not
pursued. Similarly there were few changes to the existing gas supply contracts enjoyed
by British Gas in its nationalised form and there was little initial encouragement given
to potential competitors to the dominant firm. As was noted in chapter 2, revenue
considerations and the political need to ensure the success of the privatisation

\textsuperscript{71} See article in \textit{The Times}, 4 March 1997: "BT forced to scrap campaign".
programme may well have provided the rationale for what, on the face of it, might be thought to be a rather remarkable state of affairs.\textsuperscript{72}

The gas industry is something of a special case among the privatised utilities as it was the subject of a detailed review by the MMC, leading to a comprehensive report in October 1988 which dealt with the structure of the gas industry and pricing and supply issues between British Gas and its customers.\textsuperscript{73} The MMC report advanced proposals aimed at preventing British Gas from discriminating on the basis of price and abusing its monopoly position. In particular the MMC recommended that British Gas should have to publish a firm price schedule relating to the supply of gas to contract customers and that steps should be taken to prevent discrimination in pricing or supply.

Secondly, it recommended that British Gas should be prevented from refusing to supply interruptible gas on the basis of end use or the availability of alternative supplies. The third and fourth recommendations of the MMC report were designed to promote competition in a more direct manner. Here the MMC recommended that detailed information on common carriage terms in the gas industry should be published and that British Gas should contract for an initial maximum proportion of not more than 90\% in relation to any new gas development. These recommendations were not implemented in full by the Secretary of State, although for present purposes the detailed reception of the MMC proposals does not need to be addressed here.

The MMC report was followed in 1991 by a review undertaken by the Office of Fair Trading, which considered the extent to which the MMC recommendations had been incorporated into the operations of British Gas in the period since the report was issued. The OFT report concluded that the changes recommended and implemented had


\textsuperscript{73.} For the background to the MMC report and its conclusions see an article by the Director General of OFGAS, Mr James McKinnon, "Whatever Happened to the British Gas Corporation?" (1990) 1 Util LR 134 at 135-137; Cameron, "Five Years of Regulating Britain's Gas Industry" (1991) 2 Util LR 70; Davis and Flanders, "Conflicting Regulator Objectives: The Supply of Gas to UK Industry" in Bishop, Kay and Mayer, \textit{ibid}, chapter 2.
generally been "ineffective in encouraging self-sustaining competition to British Gas" and that "further remedies are required if competition is to develop more strongly."\textsuperscript{74}

There is no doubt that the power of MMC referral contained in the legislation governing the regulation of the privatised utilities forms a significant part of the regulatory structure.\textsuperscript{75} Indeed the view has been expressed that the real regulatory power in this area rests almost exclusively with the MMC rather than the individual Directors General.\textsuperscript{76}

(ii) The Move to Competition in the Gas Industry

In recent years the structure of the gas industry has changed markedly. Fresh proposals for opening the domestic gas market to competition were introduced into Parliament in March 1995 in the form of a Bill containing proposals for progressive liberalisation of the gas market, with full competition to be put in place by 1998.\textsuperscript{77} The Bill was supported by the Director-General of Gas Supply, who agreed that there would be


\textsuperscript{76} See National Consumer Council, \textit{In the Absence of Competition} (HMSO, London, 1989), p 19: "Their powers are primarily administrative, checking that the regulated industry is conforming to a set of conditions which they have no part in setting. They lack the United States public utility commissions' legislative powers to make rules, their judicial powers in deciding ...tariff cases, have no role at all in investment decisions, and even lack most of the significant executive powers ... The real \textit{regulatory powers} lie, if anywhere, with the Monopolies and Mergers Commission."

\textsuperscript{77} See article in \textit{The Times}, 2 March 1995: "Competition Bill set to inflame debate over gas."
competitive benefits resulting by way of increased market choice and lower costs to consumers,\(^78\) and was passed into law as the Gas Act 1995.

During 1995 OFGAS issued a number of consultation and policy papers relating to the proposed competitive structure for the industry and a review of price controls over various parts of the business of British Gas. Regulatory activity in late 1995 and early 1996 revolved around proposed price controls by OFGAS in respect of TransCo, the distribution arm of British Gas. OFGAS voiced concerns that the transmission activities of British Gas's business should be administered separately from the trading and supply divisions to avoid the possibility of cross subsidy and pricing distortions. In late 1996 British Gas decided to demerge these two arms of its business with effect from early 1997. This prompted OFGAS to request the MMC to investigate and report on the general issue of price controls over gas transportation and storage.\(^79\)

At an extraordinary general meeting on 12 February 1997 in Birmingham, shareholders approved the demerger of British Gas into two companies, one to be called Centrica, which would carry on the gas supply business, and the other to be called BG plc, which would carry on the TransCo transmission business.\(^80\) The demerger took effect on 17 February 1997.\(^81\) The remaining small shareholders in British Gas, numbering about 1.7m, became entitled to receive one share in the new Centrica company in exchange for each share which they held in British Gas. The demerger caused immediate losses to private investors in British Gas,\(^82\) and this news was quickly followed by the

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\(^78\) For a summary of the provisions of the Bill see article in *The Times*, 20 February 1995: "Opening up the gas market." The progress of the Gas Bill through Parliament is described in an article in *The Times*, 14 March 1995: "Uncertainty over price of cheaper gas."

\(^79\) See article in the *Financial Times*, 8 October 1996: "British Gas: MMC may widen probe"; MMC Press Release 15/96, "MMC invites views on the price control for British Gas TransCo" (MMC, London, 14 October 1996); article by Pennington in *The Times*, 6 December 1996: "Turn off the gas man".

\(^80\) See article in *The Times*, 13 February 1997: "British Gas job cuts out of control".

\(^81\) See article in *The Times*, 17 February 1997: "Demerged British Gas welcomes dawn of a new era".

\(^82\) See article in *The Times*, 18 February 1997: "Private investors count the cost of Gas demerger".
announcement at the end of February 1997 of a substantial loss of £571m for British Gas as a consequence of restructuring costs incurred prior to the demerger.\textsuperscript{83}

An MMC review of the pricing formula proposed by OFGAS was sought and this was still proceeding as at September 1997. Its outcome will be awaited with interest, particularly as to whether the MMC upholds the approach taken by OFGAS on pricing issues, a matter on which OFGAS itself does not appear to be totally confident.\textsuperscript{84}

7.4.4 Electricity

In the case of the electricity industry, similar regulatory arrangements were put in place under the Electricity Act 1989, with the Office of Electricity Regulation (OFFER) being established.\textsuperscript{85} The first annual report by OFFER, in 1990, was published prior to the then proposed privatisation of the two electricity generating entities, National Power and PowerGen, and caused some uncertainty in terms of the regulatory approach to be adopted.\textsuperscript{86} A significant report by the House of Commons Energy Select Committee published in February 1992 drew attention to the need to reduce the dominance of these two generating entities by recommending a redefinition of the goals

\textsuperscript{83} See article in \textit{The Times}, 28 February 1997: "British Gas signs off with final-year losses of £571m." It is interesting to note in this context that the two names, BG and Centrica, for the demerged entities were decided upon after British Gas had incurred expenditure with a London consultancy totalling some £250,000. See article in \textit{The Times}, 6 December 1996: "New name game costs £250,000." The writer cannot help observing that he would have been prepared to apply all his available imagination to the task for a slightly lower level of remuneration! For corporate information on the demerged entities see their internet web sites at http://www.bgplc.com/ and http://www.centrica.co.uk/.

\textsuperscript{84} See article in the \textit{Sunday Times}, 26 January 1997: "British Gas may escape tough Ofgas price cuts".


\textsuperscript{86} See Editorial note, "Regulation and policy making in the 1990's - First annual reports from OFWAT and OFFER" (1990) 1 Util LR 58.
of the pool pricing system put in place following privatisation. The Committee also recommended that the regulator should recognise his primary obligation as being protection of the consumer interest and that this should be reflected in the price control formulae applicable to the regional electricity companies.

Recent regulatory activity in the industry has focused on preparing the market for full liberalisation from 1998 onwards, at which time so-called second-tier suppliers will be able to compete with the existing monopoly franchisees for business from the whole range of available customers. This has involved a number of aspects, including the developments of consumer and marketing codes of practice, accompanied by calls from the regulator for increased transparency by the electricity companies in terms of the supply of detailed regulatory information. Another relevant factor has been the intense merger and takeover activity in the industry, involving takeovers of the regional electricity companies, frequently by US and European interests, so that by the end of February 1997, only one regional electricity company, Southern Electric, remained as an independent operator.


88. For a discussion of the proposed structure and characteristics of the competitive market see an article by Villiers, "The Competitive Electricity Market from 1998" (1996) 7 Util LR 55.


91. See article in The Times, 24 February 1997: "US Utility Set to Bid for Yorkshire Electricity"; article in The Times, 25 February 1997: "Yorkshire Electricity Accepts £1.5bn US Offer". These articles detailed the successful bid for Yorkshire Electricity by Yorkshire Holdings, an American consortium owned equally by American Electric Power of Ohio and Public Services of Colorado. It was thought that the timing of this bid was motivated by the perceived need on the part of the offeror to obtain approval of the takeover prior to the forthcoming general election. The approval process generally takes up to 35 working days from the making of the takeover bid, a timetable which would result in approval being given only a few days prior to the date of the election in May 1997.
Initial draft licences for electricity suppliers from 1998 were published by OFFER on 23 April 1996. These licences included provisions setting out the rights and obligations of the parties, a Contract Terms Code providing for published terms of contract to allow for inter-supplier comparisons to be made, provisions for public reporting requirements and a Competitive Supply Code setting out procedures for changing suppliers. Revised proposals were issued by the regulator in August 1996. A number of Codes of Practice for the 14 public electricity suppliers had been approved by OFFER by September 1996.

The regulator published detail proposals on price controls for electricity transmission services in October 1996 which were designed to benefit customers by up to £1bn. In December 1996 the regulator issued a statement on the detailed arrangements which OFFER proposed for introducing competition in a controlled fashion in April 1998.

The timing of the introduction of full competition seems somewhat uncertain at the present time. The regional electricity companies themselves have been lobbying intensively for a deferment of the proposed commencement date of 1 April 1998 and it is thought that full competition in domestic electricity supply is not now likely to occur for some six to nine months after that date. As of late January 1997 the then Labour Opposition was facing increasing pressure to delay or postpone the introduction of full competition on the basis that the proposed programme had not been trialed effectively and had been poorly managed. The electricity regulator was reported in

94. See OFFER Press Release, R48/96, 26 September 1996: "Protecting Electricity Customers".
95. See OFFER Press Release, R53/96, 3 October 1996: "Customers to Benefit by £1bn Through Revised Price Control".
96. See OFFER Press Release, R64/96, 2 December 1996: "Arrangements for Opening the Electricity Market to Full Competition in 1998".
97. See article in The Times, 2 December 1996: "Lobbying by Rees delays onset of competition". For a discussion of some of the difficulties arising here see McHarg, "Electricity - Full Supply Competition Faces Obstacles" (1997) 8 Util LR 35.
98. See article in The Times, 25 January 1997: "Labour pressed to delay power market if elected".
early February 1997 as having prepared contingency measures to address shortcomings in the proposed competitive mechanisms to be introduced in 1998, although the regulator's proposals for industry price control in the period up to April 1998, released in July 1997, have been criticised by the electricity companies.99

7.4.5 Water

In the case of the water industry, this was restructured and privatised under the Water Act 1989.100 The legislation established an industry regulator in the form of OFWAT under the control of the Director General of Water Services.101 The regulator is principally concerned with economic regulation of the industry, standards of performance and dealings between the water companies and their customers. OFWAT also has certain responsibilities in the environmental area in relation to consents for the discharge of trade effluent and similar matters. The Act itself allows for detailed regulatory conditions to be included in Instruments of Appointment which are effectively a form of rule making. The ten privatised water companies were sold in December 1989 for a price of £2.40 per share, raising a total of £5.24bn from the government.102

To a very real extent, the water companies represent one of the last remaining natural monopolies in the true sense of the term. However, among the privatised industries, the water industry and its regulation has proved to be one of the more, if not the most, controversial example of its kind. Public and consumer discontent has focused in


102. This compares with an average 1995 price of some £5.00 per share, with some companies being valued up to £8.00 per share, figures which lend substance to criticism of the prices at which privatised assets were sold during the late 1980s.
particular on instances of alleged incompetence and mismanagement, unjustifiably high levels of prices and excessive executive pay and remuneration.\textsuperscript{103} This has been against a background of intense merger activity combined with relative inertia in terms of capital investment in the industry.

Regulatory activity in the industry has certainly focused on these areas, as the OFWAT annual reports, consultation papers and press releases show.\textsuperscript{104} To begin with the issue of company performance, several of the water companies have been the subject of stringent criticism from the industry regulator. Perhaps the most notorious example has been that of Yorkshire Water, which came perilously close to imposing water rationing in its area during the summer and latter part of 1995 and which had found it necessary to impose drought orders during 1984, 1989, 1990 and 1991 despite adequate rainfall during those years.\textsuperscript{105}

Concerns during 1996 over the threat of drought conditions led to the Environment Agency pressing for statutory powers to force water companies to share supplies with water companies in neighbouring regions in the event of shortages, an interesting example of the potential for collision between social and commercial values in relation to the privatised water industry.\textsuperscript{106} Such proposals have more recently been taken up by OFWAT, which has recently advertised modifications to some 13 water company licences recording a voluntary offer on the part of those companies to pay

\textsuperscript{103} While all of the privatised utilities have been criticised for allowing excessive executive remuneration, the water companies have been among the most prominent of targets here. They have even faced attack from the Institute of Directors and from the Chairman of the Greenbury Committee itself, Sir Richard Greenbury, Chairman and Chief Executive of Marks & Spencer. See for example article in the Sunday Times, 22 January 1995, "M&S chief slams water bosses' pay"; article in The Independent, 31 March 1995, "Water firms try to shed greed image".

\textsuperscript{104} For general discussions of the principal areas of regulatory concern in the water industry see Editorial note, "Regulation and policy making in the 1990s" (1990) 1 Util LR 58; Byatt, "The Office of Water Services: structure and policy" (1990) 1 Util LR 85; Legge, "OFWAT Annual Report 1993-94" (1994) 5 Util LR 117.

\textsuperscript{105} See for example article in The Times, 13 November 1995, "Christmas cuts threatened in Yorkshire"; article in the Independent on Sunday, 17 March 1996, "Watchdog damns Yorkshire Water for 'persistent mismanagement' ".

\textsuperscript{106} See article in the Independent on Sunday, 18 August 1996, "Water firms face tough drought controls".
compensation to customers where an interruption to the supply of water has been authorised by a Drought Order.107

However, it is in the area of capital investment that the regulatory regime for water has arguably been most lacking. The water industry, in common with the electricity and gas industries, has witnessed a severe slump in investment spending over the past few years. Some critics have alleged that this shortfall in spending has been a deliberate policy to allow the companies to pay excessive profits and shareholder dividends, emphasising the fact that inadequate regulation can lead to shareholder interests taking precedence over those of other stakeholders in the regulatory process.108 The issue also highlights the difficulty of attempting industry regulation on the basis of price control, thereby creating a corresponding incentive for companies to reduce investment expenditure so as to increase profits by this means, thereby circumventing regulatory restrictions.109


109. Again, Yorkshire Water came in for more than its share of criticism on this aspect, having sought shareholders' approval for a share buyback of £140m after making record pre-tax profits of £162.2m in 1995 and £142m in 1994. See article in The Times, 6 June 1996, "Yorkshire in £140m share buyback plea". The Labour Shadow Environment Secretary, Mr Frank Dobson, was reported in that article as saying: "Under this Government, the privatised companies are allowed to get away with anything - rip off customers, leak one-third of their water, damage the environment - yet they're not properly regulated and they pay next to no tax." Yorkshire Water's plans to return this sum to shareholders, but without any corresponding customer benefits, gave rise to immediate and savage criticism from consumer groups demanding regulatory
The area of pricing has also been highly contentious in the water industry. Despite persistent criticism from consumer groups, the then Labour Opposition and the industry regulator, coupled with occasional bursts of regulatory activity, the industry's performance in this area has clearly been less than satisfactory. The Director General of Water Services has recently threatened to impose more stringent price limits on regulated water companies when the next OFWAT pricing review occurs in December 1999. He has also suggested that excessive water company profits will be cut back by linking profit levels to customer prices, a system which would have the effect of allocating a higher proportionate level of benefit to customers as compared with shareholders.\textsuperscript{110} Confidence in the regulatory regime was unfortunately not bolstered by revelations at around the same time that OFWAT itself had overspent its annual budget and was guilty of various accounting irregularities to the extent that the National Audit Office, in an unprecedented move, had declined to approve its accounts.\textsuperscript{111}

Despite its arguably mediocre performance as a regulatory body, OFWAT has nevertheless introduced some commendable innovations. In terms of public access to information, the regulator made public over 8,000 pages of company information during December 1996, in the form of the annual returns submitted by the water companies in England and Wales, for the purpose of encouraging independent analysis

\textsuperscript{110} See article in \textit{The Times}, 31 January 1997, "Yorkshire payback proposal attacked": "Sharon Dee, senior researcher with the Consumers' Association, said: 'We're concerned that a company that is able to offer that scale of benefits to shareholders does not have a tight enough [price] cap. This sort of imbalance between shareholders and customers throws the whole industry into disrepute'."

\textsuperscript{111} See article in \textit{The Times}, 13 February 1997, "Oftwat vows to cut price of water"; article in \textit{The Times}, 4 March 1997, "Water firms face prices shake-up". This approach has been reflected in OFWAT's recent press releases. See for example OFWAT Press Release 41/96, "OFWAT Announces Review of Water Company Price Limits" (OFWAT, Birmingham, 15 October 1996); OFWAT Press Release 7/97, "Water Customers Should Expect a Reduction in Prices at the Next Review" (OFWAT, Birmingham, 12 February 1997); OFWAT Press Release 9/97, "Customers will get the Lion's Share of Water Companies' Efficiency Savings Says Regulator" (OFWAT, Birmingham, 3 March 1997).

See article in \textit{The Times}, 7 February 1997: "Byatt in hot water over sums" which reported that: "Ian Byatt's office spent £400,000 more than it had been allocated by the Government and did not get Treasury approval when awarding a contract to consultants in the 1995-96 financial year. The National Audit Office, the public spending watchdog, rebuked Oftwat for those and other procedural failures and refused to endorse the accounts of the regulator. It is the first time that the audit office has taken such action."
of the material. Similarly, in January 1997, OFWAT published detailed proposals aimed at ensuring accounting separation between water companies and their parent groups with the object of preventing cross subsidy and ensuring that costs of unregulated activities were not passed on to water customers. Later that month the Director General took 12 water companies to task for capital underspending, obliging them to compensate by making customer rebates available or by reducing the K factor in the RPI + K water industry pricing formula.

These commendable initiatives have done little to dampen the outspoken criticism of water prices generally. The OFWAT National Consumer Council has been particularly critical here, comparing falling utility bills in other industries with persistently high levels of water prices. It may be that moves to promote competition in the water supply industry will improve the position. However, in the meantime it is perhaps not being too unfair to suggest that, alone amongst the privatised industries, OFWAT arguably has the unenviable reputation of being the least effective of the industry regulators, at least from the perspective of protection of the consumer interest.

So far as competition in the water industry is concerned, the situation is less straightforward than in the case of some of the other privatised utilities. In conceptual

\[112\] See OFWAT Press Release 50/96, "OFWAT Opens its Doors to Open Government" (OFWAT, Birmingham, 13 December 1996). In that press release the Director General, Mr Byatt, stated: "Access to information on company performance is an important regulatory and public issue. In my view most information should be available to the public so that they can judge for themselves that their interests are being protected."


\[114\] See article in The Times, 31 January 1997, "Ofwat forces 11 companies to make customer paybacks". A similar initiative was undertaken by North West Water in March 1995, which offered customer rebates following a profitable year of operation. See article in The Times, 31 March 1995, "Water firms offer rebates to customers".

\[115\] See for example OFWAT National Customer Council Press Release 2/96, "Customers Call for Crackdown on Rising Water Bills" (ONCC, 12 February 1997). (The text of this and other ONCC press releases can be found on the internet at website page http://www.coi.gov.uk/coi/depts/GON/GON.html.) In that press release the Council Chairman, Mr Gardner, noted: "Since privatisation, customers have seen above inflation increases in their bills to pay for the large investment programme which has put water quality at its highest level in history and has led to substantial improvements in environmental quality standards. While they want quality and environmental obligations to be met, the priority for most customers now is to see bills actually fall in real terms."
terms, it is possible to envisage competition occurring in the industry in several ways. Providing issues of interconnection could be resolved, water companies could agree to use a competing company's piping network to deliver water to customers and competing companies could be permitted to make their own connections to the same water main. From the perspective of customers themselves, it might also be possible to remove or lessen restrictions on regional supply so as to enable water companies to supply customers in other areas.116

The proposals took on more tangible form when a report on the issue by the Department of Environment was issued in April 1996. This had the expressed aim of encouraging effective competition in the water supply market by appropriate legislative changes.117 Such suggestions have gathered momentum over the past few months. Mr John Gummer, the then Environment Secretary, announced in January 1997 that the proposals set out in the Department of Environment Report of April 1996 would be implemented, initially with respect to large industrial users.118 In a press release issued in March 1997, OFWAT suggested that more opportunities for competition in the industry could result if suppliers were to compete with each other for available supplies of water.119

116. Such proposals have been under discussion for some time. See for example OFWAT Press Release 15/95, "More Competition is Needed in the Water Industry" (OFWAT, Birmingham, 4 July 1995), noting that transportation costs for water were considerably greater than the corresponding costs of transporting electricity or gas but that nevertheless it should still be possible for competition to be introduced in certain areas: "But competition could be facilitated further by some legislative changes. It may be practicable to place a limited common carriage obligation on companies to supply single customer inset appointees provided that the water quality implications were carefully considered. It would also be possible to extend cross boundary access to non-domestic water supplies. Any such changes would be for the Secretary of State for the Environment to consider."


118. See article in The Times, 29 January 1997, "Plans in motion for water shake-up".

119. See OFWAT Press Release 10/97, "Water Regulator Says Potential For Competition in Water Industry Not Being Fully Exploited" (OFWAT, Birmingham, 13 March 1997): "Competition is more likely to thrive if suppliers or potential suppliers have reasonable access to the raw material - water. The development of new resources is an important element in the development of competition." For a recent academic discussion of some of the difficulties of introducing competition into the water industry see Robinson, "Introducing Competition into
It remains to be seen whether these initiatives will have the longer term effect of driving down consumer prices. Given the more limited scope for introducing genuine, widespread competition into the water supply industry it seems more likely, however, that a strong and proactive regulatory regime will be required for some time in the future if the industry is to retain what credibility it has left with its customers. Like the ancient mariner, whose parched vision of vast expanses of non-potable water has remained an enduring part of our literature, so the task of conveying water from lakes and reservoirs to customers at reasonable prices still seems to elude us even as the 20th century draws to a close.

7.4.6 Regulatory Approaches

(i) Regulatory Independence

Advocates of theories of regulatory capture are often anxious to identify examples of captive behaviour in regulatory bodies. However, in the case of the regulators of the UK privatised utilities, experience has shown that the individual industry regulators have from time to time been prepared to take an active, even aggressive, stance in relation to the regulated companies. The first regulator of the gas industry, Mr James McKinnon, for example, was a semi-retired accountant who was widely assumed to have been given the job as a sinecure. In fact he turned out to be an active critic of the industry, imposing a stringent price-capping formula on British Gas, with its reluctant agreement, in April 1991.¹²⁰

The current Director-General of Gas Supply, Clare Spottiswoode, has also pursued an active role in relation to regulatory matters.¹²¹ She has been willing to demonstrate her

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¹²¹ OFGAS has published various consultation documents directed at promoting efficient gas usage and improving the industry from the perspective of consumers. It has also undertaken a formal investigation into discounting arrangements offered to customers who pay their bills by direct debit. For a discussion of these matters see "Promoting the Efficient Use of Gas and Improved Service Standards of Gas Consumers" (1993) 4 Util LR 117; article in The Times of 14 March 1995: "British gas direct debit discounts under investigation by regulator." Certainly the
independence from Government pressure, as a recent example from 1994 illustrates. At that time she resisted an attempt by the Government to have her impose energy-efficiency objectives on British Gas, in the course of which she effectively emasculated the embryonic Energy-saving Trust, which was to have been financed by money raised from household gas bills. Ms Spottiswoode took the view that a British Gas subsidy for the purposes of insulation of private homes effectively amounted to a tax on gas users who did not receive the subsidy. More recently she has been a stringent critic of BG's pricing policies and corporate structure.

These examples have shown that under the new regulatory regimes the regulators are indeed tending to exercise a considerable degree of independence in practice in terms of policy making. This situation contrasts with the perennial political influence which was often applied to the boards of the public corporations during the era of nationalisation, as was seen in chapter 2. However it cannot be said that the concept of regulatory independence in the privatised utilities has met with unanimous approval at the political level.

Chairman of British Gas, Mr Richard Giordano, had no hesitation, at the company's annual meeting on 31 May 1995, in blaming the strictness of the regulatory regime for losses in profits which he claimed totalled £3 billion. See article in *The Times*, 1 June 1995: "Regulator has cost British Gas £3bn." (Despite these apparent difficulties with falling profitability the directors did not feel reticent in awarding themselves substantial pay rises, under which the Chief Executive, Mr Cedric Brown, was to receive £475,000 a year, exclusive of share options estimated to boost his annual income to over £1m in total, and Mr Giordano was to earn £450,000 a year for devoting 75% of his time to British Gas - see article in *The Times*, 8 April 1995: "Pension funds challenge British Gas pay rises.

A similar approach in this area was taken by Professor Littlechild, the electricity regulator. Both regulators maintained their position in the face of strident complaints from members of the Environment Select Committee that these actions would oblige the Government to renege on undertakings given by it at the Rio Earth Summit Conference.

See for example, article by Pennington in *The Times*, 5 February 1997: "Cold front for competition"; "Dick Giordano, chairman of British Gas, must be wondering whether he once ran over Clare Spottiswoode's cat. Certainly she will not rest until TransCo, the shipping and storage arm, is riven into a million pieces."; article in *The Times*, 14 February 1997, "Regulator in fresh TransCo attack"; article in *The Times*, 21 August 1997: "BG heading for pricing clash with watchdog".

Thus Richard Caborn, the Labour chairman of the Trade and Industry Select Committee, has expressed concerns that specialised regulation leads to the overall policy picture being obscured. He was reported as saying: "The setting of the industrial strategy of the nation has been virtually put into the hands of a few individuals who are not truly accountable to Parliament, not transparent and who don't have to justify their decisions. Moreover, they are all appointees of the Government; they all come up for renewal. Who is regulating the regulators ?" (quoted in *The Independent*, 12 January 1995: "It's none of our business any more."
On the other hand, Ms Spottiswoode has, perhaps understandably, been reluctant to become embroiled in the recent controversy surrounding the level of executive pay and other financial benefits, such as share options, enjoyed by the top executives of British Gas. On this vexed issue she has maintained the position that any regulatory role in the pay-setting process would require specific statutory powers to be granted by Parliament and is not an appropriate area in which an external regulator should become involved. (Interestingly Ms Spottiswoode has not proved to be similarly reticent in seeking to renegotiate her own salary, estimated in June 1995 at £70,000 per annum. She was reported at that time as having sought a pay rise of some 65 per cent on the renegotiation of her contract.)

Professor Littlechild, the Director-General of OFFER, has also enjoyed a reluctant place in the limelight in recent times, particularly in relation to his decision on 7 March 1995 to set a revised price regime for the regional electricity companies as a result of his belief that at least one of the companies may not have disclosed its true profitability when the price regime was previously set in August 1994. This approach created something of a furore in the City, with an estimated £3.5bn being wiped off the sharemarket value of the twelve regional electricity companies almost overnight. The electricity regulator also demonstrated a similarly independent approach in early

125. See article in The Times, 26 April 1995: "Gas watchdog rejects pay-setting role."

126. See article in The Times of 1 June 1995: "MPs condemn 65% pay rise requested by gas regulator". The then Labour opposition appeared to be less than impressed by this action, with Mr Gordon Brown, the Shadow Chancellor, being reported as saying: "I think people would find it very strange that at a time when nurses are getting less than three per cent, a regulator also in the public sector could be asking for something more than fifty per cent." The Times reported in its article that the estimated pay of the Directors-General at that time was as follows: Mr John Swift of ORR (staff of 125): £131,000; Mr Don Cruickshank of OFTEL (160 staff): £90,000; Mr Ian Byatt of OFWAT (staff of 160): unconfirmed apart from being within the broad Grade 2 civil service banding (£67,500-£98,000); Professor Stephen Littlechild of OFFER (staff of 222): between £90,000 and £100,000; Mr Peter Davis (OFLOT) (staff of 40): £80,000. In fairness it would appear that Ms Spottiswoode's current estimated pay of £70,000 per annum does seem to be somewhat lower than that of her fellow regulators, given the extent of her responsibilities.


128. See article in the Financial Times, 14 March 1995: "Recs [regional electricity companies] could lose £2bn after regulatory changes"; article in The Independent, 8 March 1995: "Electricity price-curb fear costs £3.5bn"; article in The Independent, 8 March 1995: "Investors will have their revenge on Littlechild", with the writer of the article commenting: "Professor Littlechild is not just shifting the goalposts; he seems to have dug up the entire pitch"; article in The Times, 10 June 1995: "Flotations 'at risk' after power sale row."
1995 when he dismayed Treasury advisors about to publish the prospectus for the £4 billion power privatisation by threatening sanctions against either National Power or PowerGen if they were to break the existing electricity price agreement during that year.\textsuperscript{129}

In the case of OFTEL, the industry regulator, Mr Cruickshank, joined issue with BT over the inclusion of a fair trading condition in BT's licence, an issue which will be discussed in more detail in chapter 9. The regulator was also at loggerheads with BT over the issue of number portability and a proposed new price control regime. The latter initiative has created controversy (and generated considerable opposition from BT) especially in relation to its proposed regime which involved different price caps for different services.\textsuperscript{130}

A similarly robust approach has been demonstrated by Mr John Swift, the Rail Regulator, in areas such as his proposed plans for through-ticket purchasing, as will be seen in the next part of this chapter. In general therefore, there is little suggestion that the regulators have been captured by the regulatees. Indeed, there would seem to be little present prospect of the Directors General of OFGAS and OFTEL joining the regulated firms in the foreseeable future, and little reason to suggest that they have been behaving with this goal in mind!

(ii) Promotion of Competition through Regulatory Action

The role of the regulators in promoting competition is a significant aspect of the regulatory regime governing the privatised utilities and merits some discussion here. The essential problem was summarised in a 1995 article in \textit{The Economist}.\textsuperscript{131}

\begin{itemize}
\item \textsuperscript{129} See article in \textit{The Times}, 28 January 1995: "Regulator forces power prospectus rewrite"; article in \textit{The Times}, 9 March 1995: "Government nearly called off power sale."
\item \textsuperscript{130} See article in \textit{The Independent}, 6 April 1995: "Oftel considers new crackdown on BT"; article in \textit{The Independent}, 30 March 1995: "BT should risk a challenge to the regulator."
\item \textsuperscript{131} See \textit{The Economist}, 11 March 1995, p.15 at p.16, "How to privatisse": "But perhaps the clearest lesson from British privatisation is that, rather than regulate monopolies, it is better to get rid of them wherever possible. This was only half done in Britain's privatisation programme; in telecoms, gas and electricity the Government has struggled to introduce competition during the years after privatisation. Why was competition neglected? The biggest reason is that the
\end{itemize}
The degree of competition evident among the privatised utilities has varied considerably. The licensing regime created under the Telecommunications Act 1984 gave the regulator a close involvement in the licensing of market participants and permitted the terms of entry and of access to the BT network to be specified. Pricing policies on the part of BT which might otherwise have been designed to deter market entry could therefore be controlled. OFTEL has been active in analysing the competitive aspects of the telecommunications market, and published a comprehensive consultative document on the subject in December 1994. This document dealt in some detail with OFTEL's proposals for future interconnection regimes and the proper economic tests to be applied when setting interconnection charges.

Similar powers in respect of pricing issues have been given to the electricity regulator and, as was noted above, Professor Littlechild has not been reluctant to invoke these when he has considered it necessary. By way of contrast, the water companies have encountered comparatively little real competition in an industry which is, perhaps more than any other, a genuine natural monopoly. This situation has been reflected in the comparatively large number of complaints concerning overpricing and poor service which have been made to OFWAT and which have been mentioned in its annual reports.

Some mention should also be made at this point of the Competition and Service (Utilities) Act 1992, most of the provisions of which came into effect on 1 July 1992. This Act was designed to increase the powers of the four utility regulators and to...

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134. See the discussion by Legge, "OFWAT Annual Report 1993-94" (1994) 5 Util LR 117 at 120-121.
standardise the regulatory regime in the four privatised industries. It placed considerable emphasis on the setting and achievement of performance standards and envisaged the provision of relevant information in this area to consumers. It also put in place standardised dispute resolution procedures as between utility companies and their customers. It suffices to say here that opinions on the effectiveness of the 1992 Act vary considerably and that the jury is still out on the issue of the Act's overall usefulness.

(iii) Regulatory Powers to Compel Provision of Information

The issue of whether the regulators have adequate powers to compel the provision of sufficient information by the regulated companies remains a contentious one. There is no shortage of examples which illustrate the nature of the contest in this area between the regulators and the utility companies. In the gas industry, one of the first major regulatory collisions occurred at a quite early stage between the Director-General of Gas Supply and British Gas over information supplied to the regulator for the purpose of analysing the company's first change in tariffs following privatisation. Requested information on gas supply contracts was only produced to the regulator the day before the company's 1987 annual meeting, and then only after the Director-General had threatened to take further action to obtain the information sought. The threat of possible court action to compel the provision of information has recently been repeated by the present Director General, Ms Spottiswoode.


136. For examples of contrasting views see Ogus, supra note 75, p 317, who remarks that "The institutional framework established by the 1992 Act is, perhaps, as good as any that could have been devised." Cf McHarg, on the other hand, who observes at ibid, p 395 that the Act has had "minimal practical impact" and at p 396 that "the Act is a slight improvement on the current position ...".

137. These events are referred to by Graham and Prosser in their book Waiving the Rules: the Constitution under Thatcherism (Open UP, Milton Keynes, 1988), p 90.

138. See article in The Times, 21 January 1997, "Regulator may take British Gas to court": "The gas regulator, Clare Spottiswoode, told MPs that she expects to take British Gas to court over the utility's reluctance to provide her with information or allow her to publish formerly confidential
Similarly the controversial decision by the electricity regulator, Professor Littlechild, in March 1995, referred to earlier in this part of the chapter, to reconsider the pricing regime set in August 1994, had its genesis in the defence by Northern Electric to a takeover bid by Trafalgar House. The bid attracted controversy because of an offer to shareholders in the target company of more than £500m in incentives to persuade them to reject the takeover bid. Critics pointed, with some justification, to the fact that the regional electricity companies were obviously not as financially strapped as they had claimed when the industry's price capping regime was negotiated if Northern Electric could afford such largesse. The regulator, obviously miffed by what he regarded as underhand behaviour on the part of the industry in providing him with suspect information, reacted somewhat stringently, if not precipitately, by threatening an immediate review of the existing price regime for the industry.

These examples illustrate that the provision of adequate information to the regulator is crucial to the proper functioning of the regulatory regime. This is particularly critical in the telecommunications and electricity industries, where the regulators have direct involvement in setting the applicable pricing structures. Succeeding chapters will seek to argue that the developed use of rule-making techniques, and insistence on greater openness of regulatory procedures, will arguably serve to avoid many of these difficulties. The United States experience in this area, while by no means perfect, illustrates that adequate powers to compel the disclosure of sufficient financial and other information can greatly enhance the effectiveness of any system of external industry regulation.

It remains at this point to summarise some of the areas of concern in relation to the regulatory structures applicable to the privatised utilities. The problem areas identified below will be analysed in more detail, and some proposals for remedial action will be suggested, in the succeeding chapters of this thesis.

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information. // The Director-General of Gas Supply said at the parliamentary Trade and Industry Committee: 'I am very tempted to go to court. It is only a matter of time.' // Ms Spottiswoode complained that her job was impaired by a lack of statutory rights to gather and publish accounts and other documents which British Gas uses to argue against her price curbs.

139. See the text accompanying notes 127-128, supra.
The first issue which arises is the degree of regulatory independence which is desirable. Examples of independent behaviour on the part of the regulators have been referred to above.\footnote{See part 7.4.6(i) to this chapter.} The proponents of regulation generally argue that the regulator should be given a free hand to pursue regulatory goals independently of political interference. (Presumably, however, if the Government is thought to be sympathetic to increased regulatory powers, in order to promote the interests of consumers for example, this attitude on the part of supporters of regulation might change to one of favouring increased political input into the regulatory process.)

On the other hand, those who are concerned about the consequences of what they perceive to be excessive regulation (a body of opinion which frequently includes the regulated firms themselves) characteristically view an independent regulatory regime with considerable suspicion, if not downright hostility. Considerations of the appropriate degree of accountability to Parliament from a constitutional perspective also need to be weighed in the balance when considering such arguments.

The question of the adequacy of the regulators' powers is also an issue which is very much to the fore at present. This issue, which is related to that of regulatory independence, is again one which typically generates deep divisions of opinion. On the one hand, there is a respectable body of opinion which favours the vesting of additional powers in the regulators. The previous telecommunications regulator, Sir Bryan Carsberg, who went on to become the Director-General of Fair Trading, has not been backward in expressing his views on this subject. He noted on his retirement from office at the OFT in March 1995 the comparative ineffectiveness of United Kingdom competition law compared with European Union rules, and expressed the view that utility regulators such as OFTEL needed additional powers in order to fulfill their duties adequately.\footnote{See article in \emph{The Independent} of 6 March 1995: "UK has lost competitive edge, says Carsberg".} Labour, when in opposition, adopted a similar approach, endorsing the need for more aggressive moves to ensure fair competition in industry,
particularly in the privatised natural monopolies. These issues will be discussed further in part 7.9 of this chapter.

Finally, concerns have been expressed about the structural design of UK regulatory institutions in the utilities arena. In particular, the system of individual industry regulators has been criticised as being inefficient and a duplication of resources, especially when considering the existence of the MMC review procedure. While the United Kingdom has advocated a pragmatic approach which is designed to avoid what are perceived as some of the worst excesses of United States regulatory regimes (such as expensive and lengthy trial-like processes) some critics maintain that the UK system may err too greatly towards the other extreme, involving lack of participation by interested parties, excessive secrecy of procedure and _ad hoc_ decision making. The new Trade and Industry secretary, Margaret Beckett, has commissioned on 30 June 1997 a review of the system of UK utility regulation, emphasising principles of transparency, consistency, predictability and accountability, and focusing on how well the existing system meets the interests of consumers.

The vesting of regulatory powers over the privatised utilities in individuals rather than corporate entities such as agencies or commissions has also not escaped critical scrutiny, with arguments being advanced that regulation by individuals can readily lead to capricious and arbitrary decision making, as well as increasing the danger of regulatory capture or magnifying the effects of external political or other influence. Veljanovski has succinctly summarised his view of the contrast between UK and US issues.

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143. For a summary of some of these criticisms see Simpson, "Regulatory aspects of utility privatizations" (1992) 3 Util LR 183; Foster, "The future of regulation" (1993) 4 Util LR 110. For reference to the DTI review of utility regulation see _Financial Times_, 1 July 1997: "Consumers: Review of privatised utilities ordered."

144. See article by Hamish McRae in _The Independent_ of 23 February 1995: "The regulator must go by the board" (advancing the view that regulation by individuals is less desirable in principle than the adoption of a board or commission structure for regulatory bodies).
regulatory regimes in these areas in a recent essay.\textsuperscript{145} The challenge of regulatory design in the United Kingdom is to ensure that Veljanovski's phrase "quick, cheap and flexible" does not become synonymous with the well-known description in Thomas Hobbes' \textit{Leviathan} of the life of primitive man: "nasty, brutish and short."

7.5 \textbf{Deregulation of Local Bus Transport}

7.5.1 The Legislative Framework

The bus passenger transport industry in the United Kingdom had traditionally been closely regulated under the transport legislation since 1930,\textsuperscript{146} although the thrust of the regulatory regime was significantly altered in 1980. A 1984 White Paper identified the fact that the 1980 Act had failed to promote competition in local bus services as larger operators were still able to dominate the licensing process and had the financial strength to use the process of objections and appeals to thwart smaller operators.\textsuperscript{147}

The Transport Committee of the House of Commons then undertook an inquiry following publication of the 1984 White Paper.\textsuperscript{148} This process led to the passing of the Transport Act 1985, which was largely deregulatory in nature and led to the formation of various separate bus companies in place of existing local authority operations and Passenger Transport Authorities (PTAs). This process in itself was controversial, with many municipal operators being opposed to the new structure of

\textsuperscript{145} Veljanovski, "The Regulation Game" in Veljanovski (ed), \textit{Regulators and the Market} (IEA, London, 1991), p 15: "US regulation is relatively rigid, rule-bound, adversarial and open, with opportunities for third parties to participate. In comparison, UK style regulation is informal, discretionary, co-operative and closed. The UK system tends to be quick, cheap and flexible."

\textsuperscript{146} The Road Traffic Act 1930 instituted a licensing requirement whereby prospective market entrants were required to demonstrate why the proposed service was required, a requirement which proved difficult to fulfill in practice, with such applications being vigorously contested by the incumbent operators. The emphasis of the regulatory regime changed with the passing of the Transport Act 1980, which introduced a presumption in favour of granting a local bus service licence unless this could be shown to be against the public interest.

\textsuperscript{147} See the discussion in \textit{Buses} (Cm 9300, HMSO, Department of Transport, July 1984), paras 4.5-4.7.

\textsuperscript{148} The Committee's findings were published in \textit{The Government's Proposals for the Deregulation of Buses in London} (House of Commons Paper, HC 1992-93, 623-1).
the industry and demonstrating some resistance to the sale of their undertakings. Within London, the previous operating entity, London Transport Buses, was divided into various separate trading entities. However, outside London, the market for local bus transport was almost completely deregulated, with any prospective operator who was able to demonstrate basic fitness, being permitted to operate a bus service by giving 42 days' notice, incorporating details of the proposed service, to the Traffic Commissioner.149

7.5.2 Some Problem Areas Emerge

The 1985 legislation emphasised the potential benefits of full competition in the industry and predicted (somewhat optimistically as matters turned out) that rival operators would co-operate in co-ordinating their services in what was considered to be a fully contestable market. As with many such rose coloured visions of the market, the reality proved to be somewhat more prosaic than the government had foreseen. Far from living in a state of peaceful co-existence, competing operators, if not literally running each other off the road, certainly came close to such a situation in various areas.

It was not long before three substantial operators emerged, FirstBus, Stagecoach and Cowie, who by June 1996 were estimated to control about 56% of all UK bus services.150 The Stagecoach company, under the aggressive and determined leadership of Brian Souter, was soon immersed in controversy in respect of its operations in various UK cities, as well as keeping the UK competition authorities fully occupied in considering various proposed mergers.151


150. See article in The Times, 17 June 1996: "Buses move further down consolidation track."

151. For a description of the evolution of this company, see article in the Financial Times, 20 March 1995, "The wagon-master driven on by faith", detailing the background of Mr Souter and his older sister Ann Gloag, the founders of the company, including Mr Souter's evangelical Christian background, and somewhat uncompromising management style.
The OFT and MMC were soon dealing with numerous investigations into alleged sharp practice by the larger operators, including allegations of predatory pricing against smaller operators, collusive market sharing, price fixing and agreements between rival operators not to compete or encroach on each other's territory.\textsuperscript{152} The Office of Fair Trading felt constrained to publish a guidance booklet for bus operators dealing with such practices.\textsuperscript{153}

7.5.3 Allegations of Anti-Competitive Behaviour

Some of the less desirable aspects of the deregulated local bus industry in Britain have already been mentioned in chapter 1.\textsuperscript{154} As was noted in that chapter, the local bus industry has provided an object lesson in the dangers of a deregulated market operating in the context of loose constraints under the general competition law and which is characterised by a drive towards the attainment of dominant market power on the part of several leading operators.

Other illustrations of undesirable market practices in the industry are afforded by a study of reports of investigations conducted by the Director General of Fair Trading under the Competition Act 1980.\textsuperscript{155} One such investigation arose from a notice

\begin{itemize}
\item[152.] A perusal of the MMC reports for the years 1994, 1995 and 1996 indicates that the bus industry was involved in one merger hearing during 1994, six merger hearings and one inquiry during 1995 and two merger inquiries during 1996. Details of these reports can be found on the internet at websites http://www.open.gov.uk/mmc/rep1994.htm; ...1995.htm; ...1996.htm and ...1997.htm for the years 1994, 1995, 1996 and 1997 respectively.
\item[153.] See Restrictive Trade Practices in the Bus Industry (Office of Fair Trading publication, OFT0039, HMSO, London, March 1995). As the Office of Fair Trading noted on page 3 of this publication: "Inevitably the supply of bus services in an area, like other business activities, will involve the making of commercial agreements with other businesses. In most agreements, businesses accept certain commitments in return for an agreed benefit. Some commitments, though, can restrict competition. For example if two or more bus companies agree on fare levels, this restricts competition on prices and could be against the interest of passengers. But there are many other ways in which competition can be restricted. These are discussed in more detail later in this guide. The Act, however, is complex and has to be interpreted in the light of court decisions. Generally, therefore, we can do no more here than warn bus operators that they may need to look at the law more closely."
\item[154.] See part 1.9.2(iii) of chapter 1.
\item[155.] Section 3(2) of the Competition Act 1980 empowers the Director General of Fair Trading to give notice to the Secretary of State for Trade and Industry and the party concerned of the
given on 13 June 1989 to Kingston upon Hull City Transport Limited ("Kingston") in respect of that company's local bus services in the Kingston upon Hull area operated in competition with those of another operator, Good News Travels ("Good News").

Good News had commenced three local services in the area during 1988 in competition with the incumbent operator. It had complained to the Office of Fair Trading in September 1988 of what it considered to be blatant examples of predatory pricing by Kingston together with instances of what were said to be aggressive scheduling by the dominant operator. An investigation took place leading to a report by the Director General of Fair Trading.156

The report noted that even under the largely deregulated market for local bus transport services, established operators continued to enjoy certain advantages over prospective market entrants. These included the fact that the period of 42 days' notice under the 1985 legislation permitted existing operators to plan a response to the new service. Such a response might often be quite aggressive in nature and some barriers to entry into a particular local market were effectively still in place.157

Kingston denied that it had engaged in predatory pricing or other forms of anti-competitive conduct and provided the OFT with cost and revenue figures for certain of its routes. The OFT report noted that the conditions for the existence of predatory

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157. Ibid para 2.13: "Nevertheless, entry barriers of a different type still exist in this industry, which give established operators some advantages over new entrants. A new operator may face some time lag until consumers become aware of its service and adjust their routine to make use of it. In addition, the 42-day rule allows established operators to plan their response, although the implementation of any timetable changes is also subject to the 42-day rule. Fares are not subject to a formal notification procedure but are generally published some time in advance. Even if they are not, they will become common knowledge soon after the new service starts, so that there is little incentive for an established operator to reduce fares until faced with actual as opposed to potential competition. Potential entrants may be deterred if they believe that an established operator will reduce fares to a level that will prevent them from operating at a profit. It may thus be in the interests of an established operator to cultivate a reputation for toughness in reacting to competition."
pricing (i.e. the practice of making short term losses by a firm operating its services below average variable cost with the intention of driving competition out of the market and thereby raising prices in the longer term) were satisfied. The investigation noted that Kingston had a market share of about 76% in the particular market and enjoyed the advantages pertaining to an existing dominant operator. However, after considering Kingston's revenue figures, the OFT found that the company was still making a profit on the routes in question and had not been engaging in predatory pricing. Consequently the report concluded that Kingston had not been engaging in anti-competitive practices in the local area.

A similar investigation was undertaken in 1993 into the operation of local bus services in Southend-on-Sea by the dominant operator, Thamesway Limited. The Director General noted in his report that if predatory pricing by Thamesway was found to be present then such conduct would amount to an anti-competitive practice. However the deregulated industry structure was intended to put competitive pressure on fares so that a lowering in fare levels and an improvement in service would be expected to eventuate. Distinguishing between vigorous competition and abuse of a dominant position could therefore involve difficult value judgments.

158. Ibid para 5.6: "Predatory behaviour involves the deliberate acceptance of losses in the short run with the intention of eliminating competition, so that enhanced profits can be earned in the longer term by raising prices above the competition level. Several conditions are necessary if predatory behaviour is to be feasible. The predator must have market power and the ability to finance losses for the time necessary, whether through greater cash reserves, better financing or cross-subsidisation from other markets or products. There must also be barriers to entry in the market so that, once competition is eliminated, prices can be raised above the competition level so as to more than compensate for the period of losses, without merely attracting new entrants." For a general discussion of the concept of predatory behaviour see the OFT research paper by Myers, Predatory Behaviour in UK Competition Policy (OFT Research paper 5, HMSO, London, November 1994).

159. Ibid para 5.11.


161. Ibid para 8.3: "The distinction between a vigorous response to competition, which is generally to the benefit of consumers (and which it is a purpose of competition policy to encourage), and a predatory response which may offer consumers advantages in the short run but will reduce competition in the long run (and which may therefore justify intervention by the competition authorities), can be a fine one." For a more detailed discussion of some of the legal issues arising in this area see part 4.6 of chapter 4.
The investigation considered the costs and revenues of Thamesway in relation to the routes in question. The Director General noted that particular fares promotions by Thamesway were a genuine response to competitive environment and were not specifically aimed at driving Southend Transport out of the market. This was particularly the case given the existence of competition from the railways, which would always operate as a constraint on the dominant bus operator on the same route. Accordingly the Director General concluded that Thamesway had not engaged in anti-competitive conduct on the routes in question.

The Director General took a less charitable view of the activities of Fife Scottish Omnibuses Limited ("Fife"), which was the dominant operator of bus services in the Fife region of Scotland. An OFT investigation during late 1993 and early 1994 resulted in a report by the Director General of Fair Trading.162 Another operator, Moffat & Williamson Limited ("MWL"), alleged that Fife had been operating its competing services in an unfair manner and had been engaging in predatory pricing. In approaching its investigation, the Office of Fair Trading made its own assessment of Fife's costs and revenue for the routes in question after observing that Fife itself had made no detailed financial estimates of these matters.

The report noted that the Fife's services were closely targeted to MWL's operations on an indiscriminate basis and there was a clear inference that Fife had been engaging in predatory pricing.163 Accordingly the Director General found that Fife had been engaging in an anti-competitive practice and made a reference to the MMC under section 5 of the Competition Act 1980 in respect of the matter.


163. Ibid paras 5.33-5.36. The Report noted in particular at para 5.36: "This is likely to have had a two-fold effect on competition in Fife. First, Fife Scottish has continued to operate services on these routes. The evidence in this investigation demonstrates that they are unlikely to be profitable, indicating that the services are being cross-subsidised by another group of bus users within the Fife Scottish network. Second, the removal of Moffat & Williamson from these routes is likely to restrict that company's ability and desire to enter into competition with Fife Scottish on both commercial services and tenders for Council contracts. Potential competitors are likely to be similarly deterred from competing with Fife Scottish."
7.5.4 The Future of Deregulation

The foregoing illustrations, together with those discussed earlier in chapter 4, show that vigorous competition in a deregulated market can be difficult to distinguish from deliberately anti-competitive behaviour. The examples discussed also show that the drive to attain dominant market power may cause some operators to engage in conduct which is deliberately anti-competitive. Deregulation can also have other, equally undesirable, consequences. Competitive pressures may directly result in fleets of old, rusty and poorly maintained buses plying profitable routes to the exclusion of less profitable ones while belching clouds of black diesel smoke. There may be little incentive for responsible operators to invest in modern, environmentally friendly fleets of buses in the face of unscrupulous cut-throat competition. The situation in the UK local bus industry has led to calls for a return to a regulated environment, to address both anti-competitive market practices and also consumer, safety and environmental issues of the kind referred to above.\footnote{See article in The Times, 24 October 1995: "Days of bus deregulation are numbered"; article in the Daily Telegraph, 13 December 1995: "Bus watchdog 'needed to curb the cowboys'."}

As the experience in the New Zealand telecommunications industry which was discussed in chapter 4 has shown, a deregulated market may appear attractive from the perspective of economic theory but dominant operators can still put up formidable barriers to entry. Furthermore, excessively aggressive competition between operators in an unregulated environment can quickly give rise to serious environmental and safety issues. Only time will tell whether the local bus industry in the United Kingdom can continue to function satisfactorily in a totally deregulated environment, or whether an OFBUS will be added to the list of UK regulators in due course.\footnote{It is perhaps fair to conclude by noting that not all observers of the industry take such a pessimistic view of the deregulated structures now in place. The present Director General of Fair Trading, Mr John Bridgeman, has recently expressed the (possibly somewhat self-serving) view that the jury is still out so far as the need for specific regulation of local bus transport is concerned. See Bridgeman, "The appropriate roles of the different regulators and regulatory bodies" (A speech to the IBC UK's conference on the future of utility regulation, 10 February 1997, text on the internet at web site page http://www.open.gov.uk/of/oframes/howe.gif): "Over the past 15 years, the UK has privatised the docks, long distance haulage, British Steel, British Airports Authority, and many more. Even the privatisation of the bus and coach industries was accomplished without special..."}
7.6 Regulation of Rail and Air Transport in the United Kingdom

7.6.1 Rail Transport

(i) Rail Privatisation - Structure and Philosophy

The rail and air transport industries in the United Kingdom provide interesting illustrations of differing regulatory techniques operating in a broadly similar industry sector, that of passenger and freight transportation. To begin with rail transportation, the United Kingdom, in common with other countries, previously exhibited a longstanding tradition of public ownership and operation of railways.¹⁶⁶

The era of privatisation brought about significant changes in the structure of the rail industry. These changes were brought about by the ostensible desire of the Government to make better use of the railways and to provide greater customer responsiveness, a higher quality of service and better value for money for rail customers, while avoiding the disadvantages flowing from anti-competitive behaviour.¹⁶⁷ The basic philosophy underlying the achievement of these objectives was expressed to be the promotion of increased competition in the industry so as to realise the benefits which increased competition can achieve.


¹⁶⁷ These aims were set out in the White Paper on British Rail Privatisation, New Opportunities for the Railways (Cmd 2012, HMSO, 1992), paragraph 1. For similar sentiments see the Department of Transport Consultation Document, Gaining Access to the Railway Network (Department of Transport, 1993). For a recent general overview of economic aspects of the railways in the United Kingdom see Dodgson, "Railway Privatization" in Bishop, Kay and Mayer (eds), supra note 72, chapter 11.
This philosophy was to operate in two areas, first among operators of railway services in the passenger and freight markets and second, in the provision of the goods and services required by Railtrack, which would be the entity responsible for infrastructure maintenance and investment, consisting mainly of track and signalling equipment, and for the defining and timetabling of train journeys. Railtrack itself was a government owned company established on 1 April 1994 to take over BR's infrastructure, including track, stations and other operating equipment such as signalling systems. It was also responsible for co-ordinating train movements over the whole rail network. Initially it was publicly owned prior to being privatised in 1996, after which it was expected to provide an economic return on its assets without the need for government subsidy assistance, while raising revenue by charging operators for the use of track.

The new industry structure also provided for a Franchising Director to deal with the franchising of services to the new private sector operators. Railtrack was to purchase its services under competitive conditions, initially from British Rail and in the longer term from the private sector. Eventually the Franchising Director would have responsibility for providing adequate financial support for the railways apart from some capital grants from the Government. He would also be responsible for costing each service and determining whether a subsidy would be required and would operate under objectives set by the Secretary of State. In carrying out these objectives the Franchising Director would identify services, either singly or in groups, which would be offered to independent rail operators under conditions of competitive tender.

The new structure also involved the establishment of a Rail Regulator as an independent regulator. The Rail Regulator would be involved in issuing licences to rail

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168. For a recent discussion of the activities of Railtrack, focusing in particular on prospective liabilities to third parties such as passengers, see Cromie, "A New Track" (1995) 92 LS Gaz 24.

169. See the White Paper, supra note 167, paragraph 23. For details of Railtrack, its financial performance and operating activities see the company's internet web site at http://www.railtrack.co.uk, which includes the company's 1995/96 Annual Report and Accounts and Interim Report for the six months ended 30 September 1996.

operators (or granting exemptions from the licensing regime) and would also be responsible for resolving disputes, preventing anti-competitive practices and approving rail access agreements, including agreements between franchise service operators and the Franchising Director. In carrying out these tasks the regulator was required to deal with Rail Users' Consultative Committees together with the Central Rail Users Committee. The Rail Regulator would also consider proposals for rail service closures submitted by the Franchising Director and could convene public inquiries in relation to these if thought necessary.

(ii) Privatisation - Implementation

The new industry structure was implemented through the Railways Act 1993, which established the positions of the Rail Regulator and the Director of Passenger Rail Franchising. The Act also provided for the establishment of various Rail Users Consultative Committees to provide consumer input to the regulator on the privatisation process. The general duties of the Rail Regulator and the Franchising Director were set out in sections 4 and 5 of the Act. In the case of the Rail Regulator these included duties to protect the interests of rail users, to promote efficiency and economy on the part of rail operators and also to promote competition. These duties were also imposed on the Secretary of State under s 4 of the 1993 Act.

To assist in carrying out these responsibilities the Rail Regulator was given access to three basic policy instruments. First, the regulator had power to license both operators of train services and also infrastructure operators. This process involved an investigation into the operator's competence. The regulator could ensure that a safety validation process had been completed and might require the operator to provide

171. See Railways Act 1993, ss 4, 7-11. The British Railways Board was given statutory authority to implement the required restructuring arrangements under the British Coal and British Rail (Transfer Proposals) Act 1993.

172. For a discussion of the powers of the Rail Regulator see Glaister, supra note 170, pp 118-121; Goh, "The Railways, the Privatization and the Derailment" (1994) 5 Util LR 157; Dallas, "Railways: Regulatory Aspects of Track Access Agreements" (1994) 5 Util LR 159. The Regulator's internet home page is at http://www.rail-reg.govt.uk.
adequate insurance cover. As commentators such as Palmer have noted, these obligations exceeded those which had been imposed on other privatised industries.\footnote{173}{Palmer, Regulation of Railways in Great Britain (Essays in Regulation No. 2, Regulatory Policy Institute, Oxford, 1993), p 5: "Through the licensing machinery, the Regulator may require operators to participate in arrangements for securing 'network benefits' such as through ticketing. He is to secure that operators have due regard to the needs of the disabled. He is to require operators to follow good environmental practices. We can thus see that already obligations are being created for the privatised railway industry which are not paralleled in their already private and deregulated competitors."}

The second set of powers available to the Rail Regulator related to investigations into whether or not abuses of monopoly power by franchisees had occurred. The Rail Regulator could make a reference to the Monopolies and Mergers Commission, requiring the Commission to investigate the matter and report.\footnote{174}{See Railways Act 1993, ss 4(1)(b) and (c), 13 and 14.}

The third set of powers were in the nature of a supervisory jurisdiction. These gave the Rail Regulator the power to approve or disapprove of access contracts relating to infrastructure facilities in relation both to controls over access itself and charges for such access.\footnote{175}{See Railways Act 1993, ss 17-22.}

The Franchising Director was required under section 5 to carry out functions assigned or transferred to him in the manner which the Director considered best calculated to fulfill the objectives set by the Secretary of State. The Act went on to provide for criminal liability for unlicensed rail operators, for the issuing of licences and the granting of exemptions and for the general conditions contained in licences. The Regulator had power under section 12 to modify the conditions of a licence if the holder of the licence consented. There was power on the part of the Regulator to refer rail transport issues to the Monopolies and Mergers Commission for determination. Originally it was proposed that British Rail be excluded from bidding for franchises but this proposal was modified when the 1993 Act was enacted. However, the legislation as passed provided for the Franchising Director to have the power to exclude British
Rail from the bidding process in circumstances where the promotion of competition in the provision of rail services rendered this desirable.  

The privatisation proposals proved to be politically controversial and the then Labour Opposition suggested on more than one occasion that they would be reviewed if Labour became the Government, possibly even to the extent of returning the United Kingdom railway network to public ownership. The former Conservative Government warned that the continuation of existing rail services could not be guaranteed after privatisation and that private sector rail operators had to be given the freedom to make their own decisions on the provision of rail services.  

The legislative framework has also been criticised on the basis that the separation of responsibility for rail services and infrastructure might give rise to difficulties of coordination on an operational basis (resulting in service delays and safety issues arising), together with potential conflicts of interest, from a competitive standpoint, on the part of operators who were also the owners of the track along which the service in question operated. Concerns have also been expressed that the contractual model

176. Ibid 25(4) and (5). See also Ogus, supra note 75, pp 328-329.  

177. See articles in The Independent of 15 January 1995: "Labour draws up plan to re-nationalize railways" and in The Independent of 18 March 1995: "Head of steam builds up over rail franchises" in which it was reported that Michael Meacher, Labour's transport spokesman, had warned on 17 March 1995 that franchising contracts agreed to by the Franchising Director, Mr Roger Salmon, would not be regarded as binding by a future Labour Government. Such pressures may continue despite the controversial replacement, in March 1995, of Clause Four of the Labour Party's Constitution, which referred to "the common ownership of the means of production, distribution and exchange", with a more wide-ranging set of political objectives. In terms of economic policy, the Labour Party is now committed to working for "a dynamic economy, serving the public interest, in which the enterprise of the market and the rigour of competition are joined with the forces of partnership and co-operation to produce the wealth the nation needs and the opportunity for all to work and prosper..."

178. See article in The Times, 28 January 1995: "Rail firms to be given freedom to cut services".  

179. For a discussion of these difficulties see Goh, supra note 172, pp 157-158; Dodgson, supra note 167, pp 242-248. Patrick Hosking, writing in the City & Business column of the Independent on Sunday of 16 April 1995 noted as follows: "The theory is that these contracts will provide a legal framework to ensure quality standards. In practice, there is the grim possibility that every incident of leaves on the line, or engine failure, or electric fault, unleashes a tidal wave of claim and counter-claim... The danger is that rail privatisation will create another bureaucratic nightmare. You don't yet have to wait as long for a train as a hip op, but the auguries are not encouraging."

favoured by the legislation and involving the use of franchising agreements may not provide sufficient security to ensure the continued supply of any particular rail service. This could conceivably have political implications in the event of sustained disruption in the provision of services.\textsuperscript{181}

In addition to these difficulties at the policy level the decisions of the Rail Regulator have themselves not been free of controversy. A proposal put forward in January 1995 by the present regulator, Mr John Swift QC, to limit through-ticket sales for a range of rail journeys to fewer than 300 core stations attracted widespread criticism in the press and from consumer organisations.\textsuperscript{182} Following this groundswell of opinion the Regulator announced some three months later, on 11 April 1995, that the proposals would be withdrawn for further evaluation.\textsuperscript{183}

As well as these areas of controversy, consumer dissatisfaction has also surfaced in relation to timetabling issues, where the 25 separate rail operating companies have apparently often refused to disclose information about competing rail services along the same route,\textsuperscript{184} and have allegedly frequently failed to advise customers of the availability of cheaper fares from competing operators.\textsuperscript{185} Areas of concern such as these were earlier discussed in more detail in chapter 4.\textsuperscript{186}

On the credit side, the specific mandate given to the Rail Regulator under section 4 of the 1993 Act to encourage competition and restrain anti-competitive practices has been a positive feature of the legislation, although time will tell whether the Regulator has

\textsuperscript{181} See Dallas, \textit{supra} note 172, pp 161-162.

\textsuperscript{182} The original proposals by the Rail Regulator are set out in the ORR's paper \textit{Ticket retailing: a policy statement} (Office of the Rail Regulator, London, January 1995). See also article in \textit{The Independent}, 12 January 1995: "Rail Regulator heads for clash over ticket cuts"; editorial in \textit{The Times}, 12 January 1995: "Think it through. Rail privatization should not limit ticket availability."

\textsuperscript{183} See article in \textit{The Independent}, 12 April 1995: "BR-style ticketing will stay on line"; article in \textit{The Independent on Sunday} of 16 April 1995: "Lawyers now standing at platform two...".

\textsuperscript{184} See article in \textit{The Independent on Sunday}, 13 November 1994: "Trains vanish from the timetables".

\textsuperscript{185} See article in the \textit{Sunday Times}, 27 November 1994: "Rail staff keep quiet about ticket bargains".

\textsuperscript{186} See part 4.3.4 of chapter 4.
adequate powers to implement these objectives. While the emphasis on competition is desirable from a consumer standpoint, its achievement in practice may prove to be more difficult. This might particularly be so if the Franchising Director is unsuccessful in securing a suitably qualified rail operator to provide a particular service, a situation which might well arise in relation to less profitable routes. Similarly the prospect of widespread disruption arising out of the financial failure of an operator may not be adequately catered for under the provisions in the 1993 Act, which allow the Franchising Director to secure the continued operation of rail services after a rail franchise agreement is terminated or otherwise comes to an end. If no other operator is willing to undertake the service in such circumstances (as might well be the case if poor economic returns have caused the original operator to cease providing the service) then the effectiveness of such powers may be open to doubt.

(iii) Economic and Political Factors

The need for external regulation of the rail industry is an issue which remains controversial in itself, especially among economic commentators. Palmer, for example, points out that the railway industry is not particularly flexible in economic terms, especially compared with road and air transport, because of various factors such as its dependence on expensive infrastructure, involving the need for long run investment planning and entailing high fixed costs.

187. The Franchising Director, Mr Roger Salmon, has not sought to minimise any of the prospective problems facing passenger rail franchisees. He has approached his task with commendable frankness in his document Passenger Rail Industry Overview (Office of Passenger Rail Franchising, London, May 1995). For a summary of developments in rail franchising at the time of release of this document see article in The Independent, 22 May 1995: "Hard road for the train man." The Rail Regulator has recently formulated proposals to introduce limited competition from other operators into franchised routes with effect from April 1999, while ensuring that 'turf wars' do not eventuate in the rail industry as a result. See article in The Times, 8 October 1997: "Swift seeks to avoid railway battle".

188. See Railways Act 1993, s.30.

189. Palmer, supra note 173, p 6: "The new structure for the industry proposed by the Government will give fresh opportunities, but on the whole there is an obvious risk that it will reduce the flexibility of the industry to respond to the market. This is because the relationships between the parties will be entrenched in regulated contracts which themselves reflect the inherent rigidities I have described, and each party will be keen to defend the rights it has contractually acquired. Regulation can only reinforce that tendency."
Palmer went on to examine the economic justification for regulation of the rail industry. In relation to access to infrastructure, his view was that Railtrack had little conceivable incentive to favour one user over another or to frustrate the access process and that any residual risk of this occurring was not sufficient to justify a special regulatory regime. He believed that any problems in this area could have been adequately handled by the Office of Fair Trading. 190

In relation to the question of whether Railtrack's arrangements for access and charging were fairly structured, given the temptation, at least in theory, for Railtrack to load service charges on to operators of franchised services so as to recover them from the franchising authority, Palmer has expressed the view that in the end the franchising authority controls the financial aspects of the exercise and would be in a strong position to prevent any such activities on the part of Railtrack. 191

Rail transport operates in a public and highly politicised environment where unpopular decisions can readily lead to significant political difficulties for the Government. This is likely to lead to politicians and ministers attempting to exert considerable political influence on regulatory decisions in key areas of the industry, particularly where the availability, frequency or pricing of rail services are concerned. The position is complicated by the fact that the Rail Regulator's statutory responsibilities are not directed solely to the promotion of the interests of rail passengers, but also require the Regulator to pursue other objectives, such as the promotion of an efficient and well developed rail network. Reconciling the objectives in section 4 of the Act, where these embody a strong likelihood of conflict, may well prove to be an unenviable task for the Regulator. Furthermore, the Regulator's role in preventing abuses of monopoly position in relation to suppliers of track and infrastructure may not necessarily correlate exactly, or even at all, with the promotion of the interests of rail passengers.

Whether a rail regulator in the form of an individual person will prove to be more susceptible to external political pressures than would be the case with a commission or other form of corporate regulatory body will no doubt depend in considerable measure

190.  Ibid p 6.
on the personality and commitment of the individual in question. Political pressures are likely to be more cogent in the case of the Franchising Director, who is subject to direct political control under the Act, than in the case of the Rail Regulator, who is ostensibly politically independent.\textsuperscript{192}

(iv) Regulatory Issues and Approaches

In the case of the present Rail Regulator, Mr John Swift, this position of independence seems to be substantially the case in practice as well as in theory, although the degree of political influence sought to be applied behind the scenes can only be surmised.\textsuperscript{193} It does seem, however, that traditional theories of regulatory capture, favoured in the past by some US commentators in particular, have little or no validity in the case of a regulator such as Mr Swift. The Rail Regulator's position of apparent insulation from political pressures under the 1993 Act is itself not uncontroversial, with views being expressed that a greater degree of governmental control over the regulator's activities in such an important area as rail transport would be desirable.\textsuperscript{194}

\textsuperscript{192} For the relevant provisions of the Railways Act 1993 in this area see ss 4(5), 5(1), 8(1), 17(1) and 19(1). Evidence of the highly political nature of the Franchising Director's position was provided by the official reception to the rail fares regime announced by him on 15 May 1995. This was the subject of considerable prior input from the Government, according to \textit{The Independent} of 22 May 1995 (\textit{supra} note 187), which observed: "However, just before he [the Franchising Director] was due to issue his scheme a fortnight ago, John Major got wind of it and ensured that the fares regime looked more passenger-friendly. Unlike the rail regulator, John Swift, who only has to take into account ministers' guidance and then only until the end of 1996, Mr Salmon is a creature of government and works under the strict control of the politicians."

\textsuperscript{193} Mr Swift has been reported as saying that he was aware that the role of rail regulator would be a high-profile one. (See article in \textit{The Independent} of 12 January 1995: "Swift tries to get off on the right track.") At the time of issuing his controversial consultation paper on rail ticket sales in January 1995, Mr Swift published the paper only a few days after the Prime Minister and the Transport Secretary had given contrary public assurances that ticket purchasing facilities would remain widely available throughout the British Rail network. Mr Swift was reported on that occasion as saying that the Government only had power to issue 'formal guidance' and not to direct him and that he was an independent regulator. (See article in \textit{The Independent} of 12 January 1995, \textit{supra} note 182.) He is reported as having said on that occasion, on 11 January 1995: "I have been appointed by Parliament to promote the public interest in a new privatised railway. One of the public interest objectives is to promote the use of the network which includes the promotion of through-ticketing. I am seeking to produce a better value-for-money network."

\textsuperscript{194} As \textit{The Times} noted in its editorial of 12 January 1995 (\textit{supra} note 182), in relation to the regulator's proposal for limited ticket sales outlets: "Mr Swift's announcement was further evidence of how far astray the rail privatisation programme has gone. When the regulator's
Nevertheless, at least from a theoretical perspective, there must conceivably be a greater likelihood of such external influences being more cogent when applied to an individual than to a regulator in the form of a corporate agency. Whether the reliance which has been placed on a contractual model for the franchising of rail passenger services proves to be adequate in the longer term is likely to also be a matter of conjecture. An additional factor is likely to be the influence of EC competition and transport policy. With the move towards a single European market EC regulations governing competition in the transport industry within the member states are likely to be of increasing significance. This has already become evident in the case of air transport.

When considering the appropriate design of a regulatory body for the rail industry, consideration also needs to be given to the issue of whether the existing regulatory structures and general competition law would be adequate for this purpose. As has been noted above, commentators such as Palmer take the view that they are.

There may, however, be justifiable cause for greater scepticism as to the ability of light-handed regulation of this nature to control adequately the activities of an incumbent monopolist. The New Zealand experience with light-handed regulation of the kind advocated by Palmer, where reliance is primarily placed upon the general competition

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195. For a general discussion of possible areas in which political influence might be exerted on the rail regulator under the new industry regime, see Glaister and Travers, supra note 180, pp 54-62.

196. For a discussion of these developments see Greaves, "EC competition policy in the transport industry" (1990) 1 Util LR 176.

197. Palmer, supra note 173, p 9: "Certainly there are possible behaviours of Railtrack - or of other infrastructure owners - which could attract the attention of the OFT, the Monopolies Commission or the Restrictive Trade Practices Court. But are they such that a special Regulator needs to be instituted? Could there not be more faith in the pressures exerted in the market by the competitive modes and less faith in concepts of regulation imported from the public utilities? Would it not be sufficient to confine the Regulator to responsibilities of a Licensing Authority applying standard criteria for entry to the industry as is the case with road haulage or bus operators, and leave economic regulation to the general law? These I suggest are the questions that you need to discuss."
law and market forces as a means of exerting control over public utilities and monopolies, has proved to be less than satisfactory, as has been discussed in earlier chapters. This is especially the case with industries such as telecommunications where interconnection arrangements have to be negotiated between the market participants in the absence of mandatory regulatory procedures.

The example quoted above by Palmer of the United Kingdom road haulage industry and bus operators is also of suspect analytical value. One need only bear in mind the experience in the United Kingdom of the incumbent monopolist, in the form of National Express, which managed to maintain its market share for a lengthy period after deregulation of the transport industry.198

(v) The Future of Rail Privatisation

The above discussion, together with that in part 4.3.4 of chapter 4, has identified various actual and potential problem areas with passenger rail transport and its regulation in Britain. These problems have included lack of co-ordination and cooperation between rival operators, the fact that the system of Railtrack access charges may diminish incentives to develop new rail infrastructure and an abiding suspicion that privatisation of the rail network may not in fact lead to the promised benefits for rail passengers.

On the other hand it is fair to point out that there is some cause for optimism that a privatised rail industry can lead to an improved rail service in the longer term. Railtrack has recently come under considerable pressure from the rail regulator, who

198. See for example Thompson and Whitfield, "Express Coaching: Privatization, Incumbent Advantage, and the Competitive Process" in Bishop, Kay and Mayer (eds), supra note 72, chapter 1 at p 18: "More surprising has been the success which the main incumbent - National Express - achieved in fighting entry, the large share of the deregulated market which it was able to sustain, and the rising trend in real price levels after 1982. These unexpected outcomes have been examined in several studies...and these point to various advantages of incumbency which enabled National Express to successfully meet the threat of market entry. Such advantages included exclusive access to major coach terminals, an established brand name, an extensive marketing network, and a weak bankruptcy constraint, arising from NE's status as a subsidiary of the public-sector National Bus company (NBC)." For a theoretical discussion of the resistance of monopolies to market entry see Bos, Privatization. A Theoretical Treatment (Clarendon Press, Oxford, 1991), pp 69-70.
recently issued a blunt warning to the company that it must undertake significant increases in network investment.\textsuperscript{199} In his press release of 16 January 1997 the regulator set out four key regulatory approaches which he saw as being essential for Railtrack to observe.\textsuperscript{200} Preliminary indications are that Railtrack has taken note of these criticisms and its chairman, Sir Robert Horton, recently announced a network management system involving expenditure totalling some £16 billion over the next ten years.\textsuperscript{201} While this level of investment is impressive on paper, time will tell whether Railtrack fulfils these commitments.

Given the company's evident concern to date with satisfying shareholder demands, even at the expense of competing interests, the writer would regard this as being by no means assured. Railtrack is apparently also contemplating some ambitious expansion plans, and has recently been exploring the prospects of mounting a takeover bid for the

\textsuperscript{199} See article in \textit{The Times}, 17 January 1997, "Railtrack told to step up investment": "The Rail Regulator has issued Railtrack with its starkest warning yet that it must dramatically step up its level of investment in the railways or face severe financial penalties. // In a toughly worded statement to the company's board, John Swift, the regulator, said current spending was 'wholly unacceptable' and that its stewardship of the railways was 'disappointing in important aspects'. // Mr Swift accused the company, which was privatised in May last year, of heavily underspending on track, signalling and stations. The total shortfall has been estimated at between £333 million and £700 million. // He called on Railtrack to deliver 'an effective rail infrastructure renewal and investment programme in line with public interest objectives and with the basis on which Railtrack's access charges received regulatory approval'. // Railtrack must show that it has 'credible plans to deal with the backlog and should deliver on those plans, now that it is free from public sector financing limits', he said."

\textsuperscript{200} See ORR Press Notice 97/02, 16 January 1997, \textit{Rail Regulator Publishes Objectives for Railtrack} (text on the internet at \url{http://www.open.gov.uk/orr/press.htm}), in which the regulator noted: "As I said in December 1996, the current level of underspend is wholly unacceptable. Thus, I expect Railtrack to deliver an effective infrastructure renewal and investment programme which follows four key regulatory principles:

- Railtrack should, in a timely fashion, renew the railway infrastructure in the appropriate modern equivalent form;
- Railtrack should take a proactive and positive approach to the development of the railway network in a way which reflects the needs of its customers and rail users;
- Railtrack should make good the current shortfall in expenditure in an efficient and effective way; and
- Railtrack's plans and investment approval processes should ensure delivery of these objectives."

\textsuperscript{201} See article in \textit{The Times}, 21 February 1997, "Railtrack plans £16bn investment programme"; article by Tempus in \textit{The Times} of 21 February 1997, "Keeping track of the money". This was followed on 20 May 1997 by an announcement from Railtrack of a £1bn spending programme over the ensuing five years to upgrade railway stations and encourage retail outlets, restaurants and professional offices to set up business in stations. See article in \textit{The Times}, 21 May 1997: "Railtrack woos businesses with £1bn stations facelift".
London Underground network. The Rail Regulator has recently issued a proposed modification to Railtrack's network licence designed to increase the company's accountability to the regulator and to invest greater enforcement powers in the regulator. He has also revealed proposals to introduce limited competition to franchisees from March 1999 onwards.202

The rail franchising process generally has been regarded with approval by the National Audit Office in a recent report.203 The NAO noted that a good level of competition had been achieved among bidders for the first three passenger rail franchises, resulting in lower levels of subsidy being required. It suggested that when awarding future franchises OPRAF should review the operation of the fares regulation system, should publish the criteria which it intended to use to enable it to evaluate the benefits to be obtained from the carrying on of loss making services and should continue the practice of setting budgets for advisers' costs in respect of each franchise.

There are also signs that franchisees themselves are taking steps to improve levels of passenger service. One prominent recent example has been an order for new rolling stock placed by the franchisee, Prism, servicing the so-called "misery line" into Fenchurch Street Station in London.204

In summary therefore, while there are legitimate causes for reservation about aspects of the privatised rail network and its regulation, the overall assessment is that, like the curate's egg, it is good in parts. Hopefully the future will show that, with continuing regulatory direction, the good parts will come to outweigh the less attractive ones.


204. See article in The Times, 5 March 1997, "New trains for suffering 'misery line' passengers."
7.6.2 Air Transport

(i) Structure and Functions of the CAA

The situation with air transport regulation in the United Kingdom is somewhat different from that of rail, although some similar considerations arise. The Civil Aviation Authority (CAA) was incorporated in the form of an independent regulatory agency, a structure analogous in some ways to the typical United States regulatory agency, as Craig has noted. It is noteworthy that a specific role for the CAA in relation to the promotion of competitive practices is not expressly provided for under the Civil Aviation Act, unlike the situation applicable to the rail industry under the Railways Act 1993.

In the past the Civil Aviation Authority has undertaken some rule making activity through a variety of methods, including policy statements, annual reports, ministerial policy statements and informal communications. The CAA has also made use of hearing procedures in appropriate circumstances, such as in relation to decisions on awarding of airline routes, a process which comes close to approximating the American system of regulatory hearings. On the whole, the agency model of regulation in the civil aviation area appears to have operated reasonably effectively as a regulatory tool. Agency models have also been adopted in this area in Commonwealth jurisdictions such as Canada and New Zealand. Baldwin, one of the leading commentators on the

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206. Craig, supra note 22, p 97. "What the establishment of the CAA represented was a realisation of the benefits to be gained from administration outside of the departmental norm plus an attempt to avoid a dual problem which has beset the United States' agencies: how to maintain some political control over the agency and how to give it a clearer idea as to the manner in which its broad discretion should be exercised. The system of policy guidance was intended to achieve both of these ends."

207. See the discussion in Chataway, supra note 205, p 146.

208. For a summary of these methods see Baldwin, Regulating the Airlines. Administrative Justice and Agency Discretion (Clarendon Press, Oxford, 1985), chapter 5.

209. See Baldwin, ibid pp 192-204.
CAA, has expressed some reservations about the agency concept, principally based on its possibly reduced accountability to Parliament, but accepts that "it may be viewed as almost unavoidable". While cautioning that the agency structure should not be adopted automatically without proper consideration in any particular case, Baldwin's view was that, in a proper case, the regulatory agency could fulfill a valuable function in the regulatory area.

The CAA now has two principal areas of operation. One is in relation to the general economic regulation of air transport, including matters such as air services policy, airline tariffs, air transport licensing, charter operations and airports policy. The second area relates to airline safety regulation. In this latter respect the CAA's role resembles that of the FAA in the United States. An organisational chart for the CAA as a whole is included as Appendix I to this chapter and an organisation chart for the CAA's economic regulation group is included as Appendix II. These show a divisionalised organisation structure that is designed to cater for the differing regulatory activities of the CAA in the areas described above.

This part of the chapter focuses on the route licensing activities of the CAA as these represent what appears to be the only example of a quasi-judicial adjudicative process in current UK economic regulation. The powers of the CAA in relation to public hearings are more extensive than in the case of the hearing regime operated by its predecessor, the Air Transport Licensing Board (ATLB). As Baldwin has noted,
public hearings, along with various forms of policy announcement (the latter being particularly significant in relation to air charter policy) were important regulatory tools of the CAA in the 1970s and early 1980s. Although the decision making processes in this area involved polycentric determinations, Baldwin's analysis of the CAA's activities indicated that this did not impugn the integrity of the decision making process, given the expertise of the CAA in its particular area.215

The current licensing regime in respect of air transport licences is contained in Part III, ss 64-70 of the Civil Aviation Act 1982. Section 65 sets out the criteria for the grant or refusal of an air transport licence. The CAA has a wide discretion in relation to the terms of licences.216 It can revoke, suspend or vary licences if it considers it appropriate to do so217 and is obliged to do so under certain circumstances, mainly relating to the licence holder's fitness to operate aircraft.218 The CAA has a general duty to give reasons for its decisions where these affect air transport licences.219

The CAA is also under a duty to publish a statement of the policies that it intends to adopt in performing its air transport licensing functions under the Act.220 Before doing so it is obliged to consult representatives of the UK civil air transport industry and users of air transport services.221 The present policy is contained in a CAA document issued in May 1993,222 which sets out the CAA's general philosophy and approach in relation to route licensing. This is described as being the promotion of active competition between airlines and the development of an environment enabling efficient British

215. See the discussion in Baldwin, supra note 208, particularly at pp 196-204.

216. See s 65(5) of the Civil Aviation Act 1982.

217. Ibid s 66(2).

218. Ibid s 66(3).

219. Ibid s 67(2).

220. Ibid s 69(1).

221. Ibid s 69(3).

airlines to operate profitably in the air transport market.\textsuperscript{223} The CAA also noted the significant influence of the liberalisation of the EC transport market. It stressed that it would employ its regulatory powers to counter any anti-competitive behaviour which it perceived to be occurring in the UK air services market.\textsuperscript{224} The Act itself does not go into any detail on hearing requirements in relation to air transport licensing but specific requirements for licensing hearings are contained in regulations made under the Act.\textsuperscript{225}

(ii) The EC Influence

In recent years the importance of the public hearing regime has diminished following the trend towards the deregulation of the civil aviation industry and the effect of EC developments in this area. Since 1987, civil aviation policy has been significantly influenced by progress towards attaining a single market in the European Community. The current UK regulations relating to air carriage in the European Community are contained in the so called "Third Package" of regulations which took effect on 1 January 1993.\textsuperscript{226}

\textsuperscript{223} Ibid paras 3-4.

\textsuperscript{224} Ibid, paras 6 and 12. For a discussion of the CAA's approach to the issue of anti-competitive conduct see Prosser, "Legal and Administrative Problems of Airline Deregulation in the United Kingdom" in Bridge et al (eds), \textit{United Kingdom Law in the Mid 1990s} (United Kingdom National Committee of Comparative Law, 1994), pp 332-335. The CAA's approach in relation to anti-competitive market practices bears some resemblance to the stance adopted by OFTEL in this area, as is described in part 9.6 of chapter 9. Clause 24 of the Civil Aviation Authority Regulations 1991 (SI 1991, No 1672 as amended), allows the CAA to conduct a preliminary hearing into alleged anti-competitive behaviour, with the power following such a hearing to impose a provisional licence variation. This can be followed by a full hearing under Regulation 25, which can then lead to a permanent order being made.

\textsuperscript{225} See the 1991 Regulations, \textit{ibid}. For a general discussion of the requirements relating to CAA public hearings see Blackshaw, \textit{Aviation Law & Regulation} (Pitman Publishing, London, 1992), chapters 6-11.

These regulations prescribe standard criteria for the licensing of air carriers within the European Community. Providing an air carrier can show that its principal place of business is located in a member state, that it is engaged principally in air transport and otherwise meets the requirements of the licensing regulation, then that carrier is entitled to the issue of an air transport operating licence.\textsuperscript{227} Similarly, in relation to route access, licensed Community air carriers are entitled to operate on any EC air route, subject to a transitional period expiring on 1 April 1997 in respect of cabotage (i.e. cabin passenger) traffic rights.\textsuperscript{228} Finally, fare regimes no longer require regulatory approval and must simply be filed in advance with the relevant Member State.\textsuperscript{229}

Apart from their effect in liberalising EC air transport policy, these regulations have also had a direct effect on the route licensing hearings undertaken by the CAA. Since the regulations took effect in January 1993, CAA public hearings on route licensing matters are now confined to air routes outside the European Community. This has been reflected in a much smaller number of air transport licensing hearings than in previous years.\textsuperscript{230} As British Airways and Virgin Airlines are at present the only two long haul international operators based in the United Kingdom, and as these two airlines largely operate over established routes, it seems unlikely that the CAA public hearing regime will attain its previous level of importance in relation to air route licensing. This has been reflected in a corresponding reduction in the number of staff engaged in air route licensing matters at the CAA. Further significant changes are in the wind given the

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\textsuperscript{227} See Regulation 2407/92, arts 4-10.

\textsuperscript{228} See Regulation 2408/92, arts 1-8.

\textsuperscript{229} See Regulation 2409/92, arts 1-7. For a general discussion of the effect of the Third Package of regulations see Prosser, \textit{supra} note 224, chapter 12, pp 327-331.

\textsuperscript{230} Mr Peter Stanton advised me in the course of our interview, \textit{supra} note 213, that there were only two hearings in 1994 (relating to an application by British Mediterranean for travel to Middle Eastern destinations) and three hearings in 1995 (concerning charter flights to Jersey and one further application by British Mediterranean relating to a proposed service between London and Beirut).
Labour Government's recent announcement that it has decided in principle to privatise the Civil Aviation Authority.231

7.7 Self Regulation

7.7.1 Self Regulatory Regimes in Britain

It is useful at this stage to give some consideration to the advantages and disadvantages of self-regulatory regimes from the perspective of issues of regulatory design and the participatory goals discussed in chapter 5. On the credit side, such regimes are said to have advantages in terms of cost (at least from the perspective of the taxpayer if not the regulatee) and efficiency (both in terms of ease of administration and avoidance of problems arising from a lack of information concerning, and a lack of familiarity with, the particular industry). They may also attract greater industry acceptance, assuming that peer group governance is generally more acceptable than externally imposed regulatory regimes administered through a government agency.

On the other hand self-regulatory regimes may suffer from some obvious difficulties. First they may display a lack of effectiveness, arising both from indifferent enforcement and lack of effective sanctions. Secondly, a self-regulatory scheme which is not compulsory (such as a voluntary trade association) may lack sufficient power to impose adequate controls on an industry-wide basis. Thirdly, self-regulatory regimes, particularly where they operate among professional bodies, are sometimes accused of perpetuating restrictive or monopolistic practices and of operating without regard to the consumer interest. (Such criticisms may not be entirely baseless, although they are often no doubt exaggerated by critics of particular professional groups.)

Finally, the internal procedures of self-regulatory bodies, particularly in the areas of rule making and adjudication, where such activities are part of the responsibility of the

231. Mr Peter Stanton advised that, of the approximately 7000 CAA employees at the time of my interview with him, most were now involved in air safety matters. The Economic Regulation Group employed some 110 staff, of which at least half were involved with air charter regulation, with only about 5 staff now working on the policy side. The air transport licensing function involved some 20-30 staff prior to the Third Package taking effect but this number had now been reduced to about 10. On the subject of the proposed privatisation of the CAA see article in The Times, 8 September 1997: "Labour Agrees Plans to Give Private Sector Control of CAA".
body in question, may be carried on without any form of public scrutiny or input. Again, this may operate to the detriment of third parties such as consumers and investors, and the rules or codes of practice which are formulated may be loosely drafted or may be unduly lenient on the regulated interests. In their book on responsive regulation, Ayres & Braithwaite explored these difficulties with self-regulatory regimes. In their view, problems such as regulatory capture in this context could be solved by what they described as "a republican form of tripartism".

By interposing public interest groups who were empowered to participate actively in the regulatory process, Ayres & Braithwaite envisaged that such an approach would reduce the risk of corruption or capture, would create incentives for regulatory negotiation and co-operation and would enable regulatory agencies to carry out better monitoring of policy effects and outcomes. Such an approach is in harmony with the thrust of this thesis that structured consultation and participation arrangements, incorporating organised involvement by third parties representing the public interest, constitute an improved approach to the implementation of economic regulation.

The United Kingdom experience with self-regulatory regimes has been relatively varied. Professional services have traditionally been the subject of self-regulation and the legal and medical professions have in the past enjoyed considerable regulatory autonomy in organising their affairs, although such a situation has come under increasing scrutiny in recent years, particularly in the case of the legal profession.


233. Ayres & Braithwaite, ibid, p 439: "This, then, is the policy nut we seek to crack. How do we secure the advantages of the evolution of co-operation while averting the evolution of capture and corruption? Our answer lies in a republican form of tripartism. Tripartism is a process in which relevant public interest groups or non-government organisations (NGOs) become the fully fledged third player in the game. As a third player in the game, the NGO can directly punish the firm. NGOs can also do much to prevent capture and corruption by enforcing what Axelrod calls a metanorm - a norm of punishing regulators who fail to punish noncompliance."


235. For a general discussion of licensing regimes in relation to professional occupations in the United Kingdom see Ogus, supra note 75, pp 216-225. Professor Ogus is critical of some
In the case of other activities or industry groups, such as advertising, the press and the insurance industry, self-regulatory regimes have also been in existence for some time, motivated at least in part by the ever present possibility of external legislative control.\textsuperscript{236} The financial services sector, especially since the enactment of the Financial Services Act 1986, provides perhaps the most comprehensive example of a self-regulatory regime at present operating in the United Kingdom.\textsuperscript{237}

7.7.2 Financial Services and Self-regulation

It is not the intention here to detail the historical development of the United Kingdom self-regulatory regime in the financial services area as this task has been adequately carried out by others.\textsuperscript{238} However the way in which the final structure of the self-regulatory regime in this field evolved from the preliminary proposals for legislative reform in this area is significant.

\begin{itemize}
\item aspects of professional self-regulation, insofar as it constitutes direct or indirect barriers to entry and serves to protect traditional practices and methods, the maintenance of which may not necessarily be in the public interest. See also Abel, \textit{The Legal Profession in England and Wales} (Blackwell, Oxford, 1988), pp 60-62 and Faure, Finsinger, Siegers and van den Bergh (eds), \textit{Regulation of Professions} (Paul & Co, NY, 1993).


\end{itemize}
In his report on the financial services sector published in 1984, Professor Gower undertook a review of reform proposals in the financial services industry.\textsuperscript{239} He had given consideration to whether or not any regulatory regime should be based upon the model of an independent commission or on a government agency such as the Department of Trade, the Bank of England or the Office of Fair Trading. Professor Gower had little constitutional difficulty with the concept of an independent commission, noting the recent establishment of a Securities Commission in New Zealand, a jurisdiction with a "comparable constitutional structure", and also the proliferation of recently created quangos in any event.\textsuperscript{240} He set out the advantages and disadvantages of each proposal at some length in his report, concluding that the arguments were finely balanced but that there was not a sufficiently compelling case to support the transfer of departmental responsibilities to a non-departmental public body.\textsuperscript{241} In his view a regulatory body in the form of a commission could undertake the task.\textsuperscript{242}

Gower also discussed in his report the structure of the proposed self-regulatory agencies. He noted that some restraints on competition would inevitably be required and would need to be imposed through the rules of the individual agency. Those rules would need to cover the question of membership of a particular self-regulatory agency, the range of permissible activities and possibly some controls over charging for services on the part of individual members.\textsuperscript{243} Some steps would be necessary to


\textsuperscript{240} Gower, \textit{ibid}, p 18.

\textsuperscript{241} See the discussion in Gower, \textit{ibid}, pp 19-23.

\textsuperscript{242} \textit{Ibid} p 24: "... on the assumption that no Government will wish to legislate more extensively or controversially than it has to, my conclusions must be (i) that the Governmental role could be left to the Department and not hived-off to a Commission, unless (ii) if and when it is decided to introduce legislation, it is apparent that a substantial volume of direct Governmental regulation and supervision of investment business will have to be undertaken. In the latter event a self-standing Commission should be established and the Governmental role undertaken by it to the extent summarised in paragraph 3.05. If the role is left to the Department it is vital that it be afforded the financial and manpower resources needed to play it effectively."

\textsuperscript{243} \textit{Ibid} paragraph 5.02, p 40.
ensure that an agency's rules were not excessively anti-competitive and he thought that
the Stock Exchange was a particularly difficult case given the complexity of its
operations.\textsuperscript{244}

As a consequence, he proposed that the Rules and Codes of Conduct of a self-
regulatory agency should not be regarded as restrictive agreements within the meaning
of the Restrictive Trade Practices Act 1976 and should also be excluded from the
operation of the Competition Act 1980.\textsuperscript{245} The thrust of these recommendations was
largely reflected in the provisions of the Financial Services Act 1986.\textsuperscript{246}

In terms of the structure of the self-regulatory agencies and associations, Professor
Gower recommended in his report that the Council for the Securities Industry (CSI)
should continue to act as the "umbrella and co-ordinating body".\textsuperscript{247} When the 1986
Act was passed it provided for the transfer of powers to the Securities and Investments
Board (SIB) which was formed to act as a designated agency for the purposes of the
Act.\textsuperscript{248}

In its final form, the 1986 Act required persons carrying on investment business in the
United Kingdom to be authorised or exempted by the Act, with criminal penalties for
failure to comply with these requirements. Exemption was granted to the Bank of
England, Recognised Investment Exchanges and Lloyds. Under the Act there were
three principal methods of obtaining authorisation. These were first, by way of
membership of a Self Regulating Organisation (SRO), secondly by way of certification
through a Recognised Professional Body (RPB), and thirdly by way of authorisation
through the SIB. The SIB itself was a company limited by guarantee and was the

\textsuperscript{244} Ibid paragraph 5.05, p 42.

\textsuperscript{245} Ibid paragraph 5.11, p 45.

\textsuperscript{246} See Financial Services Act 1986, ss 125-126; Whittaker and Morse, supra note 237, pp 141-
144.

\textsuperscript{247} Gower, supra note 239, paragraph 6.41(f), p 69.

\textsuperscript{248} See Whittaker and Morse, supra note 237, paragraph 1.12; Financial Services Act 1986, ss 7, 15
and 114 and Schedules 7 and 8.
subject of the first transfer of the functions exercised by the Secretary of State under section 114 of the Act.249

Under the Act there were initially five SROs, The Securities Association (TSA), the Association of Futures Brokers and Dealers (AFBD), the Investment Management Regulatory Organisation (IMRO), the Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA), and the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO). Following the merger of TSA and AFBD to form the Securities and Futures Authority Limited (SFA) in April 1991 the number of SROs was reduced to four. There was a further reduction in number to three in 1993 with the merger of FIMBRA and LAUTRO to form the Personal Investment Authority (PIA).

The SIB provides an annual report to the Chancellor of the Exchequer, which is tabled in Parliament, and the authority of the SIB can be removed by Parliament on the recommendation of the Chancellor. The SIB itself is comprised of practitioners in the investment area together with some lay members representing both investors and the public generally. Its declared aim is to "achieve a high level of investor protection by promoting overall efficiency in the financial markets."250 One of the first major activities of the SIB was to put together a set of rules relating to the conduct of investment business.251


250. Securities & Investments Board, ibid, p 6.

251. Ibid pp 6-7: "The rules are designed to outlaw malpractice, to raise standards, and to require proper financial and other management disciplines within companies. These are vital, as experience shows that whilst deliberate fraud does occur, problems more often result from the lack of proper financial controls."
7.7.3 Rule Making in the Financial Services Area

The rule making activities of the SIB have been analysed in some detail by Black from the perspective of how policy decisions influence the type of rule making undertaken.²⁵² She identified two phases in SIB rule making, an initial phase when the rule books were first issued in 1987-1988 and the subsequent changes in the rules in 1990-1991 following statutory amendments enacted in 1989 (the so-called New Settlement). In her view this progression represented "a move from detailed, specific rules to vaguer, more purpose-oriented rules, with little change in their substance."²⁵³ Black considered that these developments in SIB rule making reflected a desire on the part of the Board to pursue a more sensitive and flexible self-regulatory regime in such a way as to maximise co-operation and compliance on the part of the regulated interests.²⁵⁴

SIB has issued ten Principles and forty Core Rules.²⁵⁵ The underlying rationale for this approach is that firms operating in the financial services area would be encouraged to observe the spirit rather than simply the letter of the regulatory regime, so promoting integrity in the financial markets and their practitioners. The use of more general rules could of course be viewed as a method of conferring greater individual discretion on SROs while correspondingly decreasing the degree of involvement on the part of the SIB in the rule making process. Whether proceeding in this way will achieve the desired object of increasing industry standards is probably an issue on which the jury is

²⁵². Black, supra note 249; Black, Regulators as Rule Makers: The Formation of the Conduct of Business Rules under the Financial Services Act 1986 (DPhil thesis, Oxford University, 1994); Black, Rules and Regulators (OUP, Oxford, 1997). I am grateful to Dr Black for agreeing to discuss her work in this area with me during a meeting with her at the London School of Economics & Political Science on 28 November 1995.

²⁵³. Black, supra note 249, p 103.

²⁵⁴. Ibid p 108: "The attempts to change the internal attitude to regulation were expressed through the idea of a 'regulatory contract', an idea adopted by the last two chairmen of SIB. Regulation, according to SIB's second chairman, Sir David Walker, represented a contract between the regulator and regulated, in which the regulator agreed not to interfere in the detailed operation of the regulated, but in return expected compliance which went beyond mere obedience to the letter of the law. In other words, if you, the regulated, act properly, we, the regulators, will not need to be so specific." See also Securities and Investments Board, Financial Services Regulation: Making the System Work (SIB, London, 1993), particularly paragraphs 6.1-6.5.

²⁵⁵. See the SIB publications Statements of Principle (March 1990) and Core Conduct of Business Rules (January 1991).
still out. Recent events in the City suggest that rogue practitioners and a lamentable lack of management expertise and internal control mechanisms still exist, as examples such as the events underlying the collapse of Barings Bank in February 1995 demonstrate.256 There is little doubt, however, that the financial services regulators are prepared to levy stringent fines in respect of rule breaches where the occasion demands, as a perusal of the financial press regularly reveals.257

A legitimate distinction can of course be drawn between losses to investors arising from fraud, mismanagement and breach of the rules in the conduct of investment business in the financial services area, and losses arising from the risks inherent in the investments themselves, as the SIB itself has been at pains to point out.258 The rules made by the SIB in the financial services area reflect the pervasive influence of political factors on the intensity of a regulatory regime, particularly one based on the concept of self-regulation.259

256. For criticisms of the alleged failure of banking self-regulation in relation to the Barings collapse see The Times editorial entitled "Cloud over the City" (28 February 1995); Serjeant, "The City's loss of nerve will cost Britain dear" (article in The Times, 28 February 1995); Rees-Mogg, "Who will bank in the City now?" (article in The Times, 28 February 1995). Similar criticisms have been directed at the self-regulatory regimes operating in the life insurance and pensions industries. See for example Newmarch: "Regulators fail public" (article in The Times, 19 March 1995).

257. See for example article in The Times, 31 May 1995, "Record fine for Morgan Stanley" (referring to a fine of £240,000 imposed on the US investment bank Morgan Stanley by the Securities and Futures Authority for failing to properly supervise its derivatives trading activities); article in The Times 22 August 1996, "SFA bans four from the City" (referring to banning orders and other disciplinary action imposed on four City traders by the SFA for a variety of offences); article in The Times, 10 January 1997, "SFO fines Kleinwort Benson" (referring to fines of £30,000 imposed by the SFA on Kleinwort Benson for breaches of SFA trading rules); article in The Times, 28 January 1997, "Pru fined £75,000 over Pep breaches" (referring to a fine imposed by Imro on Prudential Insurance in respect of rule breaches in the company's Personal Equity Plan division over the period 1991-1993).

258. See SIB, supra note 249, p 8: "The investor protection framework does not, however, take the risk out of risk capital. If shares in a company go down in price, or indeed, if that company collapses, that is a risk the investor must bear. SIB's regulatory powers come into play only where the conduct of an authorised investment business appears to have been in contravention of the rulebook or the law, or casts doubt on whether it is fit and proper to trade."

259. Black, supra note 249, p 116: "The association of rule type with regulatory approach means that as the political climate varies in the demands it makes for the intensity of the regulation, so pressures for different types of rules are exerted. These vary with different groups: politicians, the regulated, the media; over time, with different constituencies making different demands in different periods; and between markets. The initial demand of the Government was for tough regulation. This then changed to requiring a more flexible regulatory approach. Detailed rules are perceived as necessary in market areas where private, individual investors are involved,
The 1986 Act itself emphasised the central importance and rule-oriented approach of the regulatory regime in this area. SROs were required to adopt enforceable rules which were binding on their members and a copy of the rules was to be provided to the Secretary of State when application was made for recognition under the Act. Matters which the rules of an SRO needed to address were specified in some detail in the Act. The Secretary of State had power to direct an SRO to alter any rules which did not conform to the statutory requirements, subject to a right of appeal to the High Court. Similar provisions applied to the activities of investment exchanges and clearing houses. However the rules were required not to be more stringent than was necessary for the purpose of investor protection so as to avoid them having an anti-competitive effect. These provisions showed that the structured use of rule-making techniques was an integral part of the system of regulation of financial services provided for under the 1986 Act.

It is noteworthy, for example, that the SIB is currently seeking to obtain increased powers from the Government in relation to SROs. At present the powers of the SIB in relation to SROs are largely advisory in nature, although it is seeking to obtain additional powers to close down firms which fail to comply with its rules. There is also a view among some members of the industry that the present dual tiered system of regulation involving SIB representing the lead regulator and the SROs having

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where the objective of investor protection is seen to be of greater concern. However, in the wholesale market, where mainly professional investors are involved, investor protection concerns are outweighed by concerns for market efficiency, prompted by fears that 'over-regulation' will drive business from London.

260. See the Financial Services Act 1986, ss 8(3) and 9(6).
261. Ibid s. 10(3), Schedule 2, paragraph 3.
262. Ibid s 13.
263. Ibid ss 36-39.
264. Ibid s 119.
265. See the discussion in R v Life Assurance Unit Trust Regulatory Organisation Limited, ex p Ross [1993] QB 17 at p 23. By virtue of s 64(4) of the Financial Services Act 1986 the powers of the SIB are not exercisable in relation to authorised persons who are members of an SRO.
secondary regulatory responsibility in defined areas of the financial services industry is a duplication of effort and wasteful of resources.266

Applying Evans' conception of the attributes of a private governmental system as discussed in chapter 4267 (separation of powers, procedural due process and the consent of the governed) to the self-regulatory regime applicable under the Financial Services Act 1986, it can be seen that Evans' criteria are largely fulfilled. In terms of separation of powers, the legislative or rule making function is carried out by the SIB under the Act. Executive power is largely vested in the SROs, which can investigate disciplinary matters and can apply their rules of conduct to disciplinary proceedings. In terms of the judicial function, the SROs are generally required to observe natural justice in the course of interpreting and applying their rules and there is a right of appeal against disciplinary decisions to an appeal tribunal.268

Procedural due process is embodied in the above process and the courts have generally accepted that SROs are amenable to judicial review.269 Finally in relation to the consent of the governed, there is obviously an element of compulsion in that practitioners wishing to carry on business in the financial services area are required to observe the requirements of the Act and to maintain membership in the appropriate SRO. However, the regulated interests are of course represented on the applicable SRO and have considerable input into the regulatory procedures under the Act. Indeed political pressure exerted through City interests has proved to be a significant element in the formation of SIB rules and procedures, as was noted above.

Under these circumstances it would seem entirely appropriate to regard the self-regulatory regime in the financial services area as representing a form of private government. The courts have implicitly accepted this situation in showing a readiness to apply the remedy of judicial review in cases involving SROs and other bodies

266. See article in The Times, 22 May 1995: "SIB wants more regulatory power."
267. See the discussion in part 4.7.2 of chapter 4.
268. For a further discussion of the disciplinary functions of SROs see Graham, supra note 232, pp 206-208.
269. See the discussion in Alexander, "Judicial Review and City Regulators" (1989) 52 Mod LR 640.
operating under the 1986 Act. The foregoing analysis shows that some of the strengths of a self-regulatory regime (flexibility, adaptability and acceptability to the regulated interests) may also be combined with less desirable features such as indifferent enforcement and a lack of political commitment to the regulatory process.

The future shape of financial services regulation, and the degree to which this area will retain its self-regulating character are unknown quantities, particularly given the recent change of government. Labour, when in opposition, in its policy on City regulation, foreshadowed decreasing reliance on self-regulated financial services with the SIB being given wider statutory powers and responsibilities and representatives of the public interest sitting on the SIB board. It also favoured amalgamating the three financial services regulators into one body under the aegis of the SIB. In the event the latter proposals are to be adopted. The new Chancellor, Gordon Brown, announced on 20 May 1997 that wide ranging changes to the existing network of self regulatory bodies, now to be replaced with a new regulatory body incorporating the

270. For some of the cases in this area see part 8.3.5 of chapter 8. Not all of the judicial review proceedings have been successful, particularly in relation to challenges to the validity of rules made by the various self-regulating organisations. For example, in *R v Securities & Investments Board and ors ex parte Sun Alliance Assurance Society plc and ors* (QBD, Sedley J, 31 August 1995), the court held that the 1994 rules constituting the Investors Compensation Scheme, made by the SIB under delegated legislative powers, were within the powers conferred by s 54 of the Financial Services Act 1986 and were accordingly valid.


272. See article by Miller in *The Times*, 30 January 1997, "Battle lines are being drawn for role of City watchdog supremo": "On the shape of the financial services legislation that an incoming SIB chairman will oversee, Labour is again suitably reticent. What seems to be clear, however, is that the new Government would not massively rewrite the 1986 Financial Services Act. It is more likely to introduce a short parliamentary Bill that would enable the structure to be put in place. This could involve folding the three frontline regulators into a body simply known as the SIB." Similar proposals for one comprehensive financial regulator covering all areas of the financial services sector have been advocated in Australia. See for example article in *The Australian Financial Review*, 30 August 1996, "NatMut urges one financial mega-regulator", referring to submissions made by National Mutual Insurance to the Australian federal government Wallis inquiry into financial services regulation: "National Mutual has urged the Federal Government's financial inquiry to create a mega-regulator by blending the supervisory roles of banks, insurance and building society supervisors. // National Mutual is the first of the six major financial institutions to release its submission to the Wallis inquiry. // It also backs a separate consumer protection authority for the finance industry, advocates scrapping of constraints on foreign investment in it, and calls for the Reserve Bank's supervisory and monetary policy arms to be separated."
present SROs, would be implemented and that a new Financial Services Bill would be presented to Parliament in November 1998.273

7.8 The Evaluation of Explanatory Theories of Regulatory Behaviour in the United Kingdom Context

7.8.1 Some Political and Cultural Differences Compared with the United States

Chapter 6, on US regulation, discussed various explanatory theories of regulatory behaviour.274 In seeking to apply these theories of regulatory behaviour in the United Kingdom context, some obvious institutional differences need to be considered. To begin with, the United Kingdom is a unitary system with an unwritten constitution. Conflicts between the executive and legislative arms of government, while they are undoubtedly present, therefore do not follow exactly the same pattern as is the case in a federal system. The Executive cannot veto Parliamentary legislation and the judiciary, in terms of accepted principle, cannot declare Acts of the Parliament to be unconstitutional. The law-making authority of Parliament is sovereign, or supreme, and the constitutional status of the Prime Minister is somewhat different from that of the President under a republican, federal system.

In the United States federal statutes frequently delegate legal powers to regulators rather than to the Executive. The President has limited influence over the composition of regulatory commissions and any Presidential attempt to intervene directly in the regulatory process may carry its own political consequences. These features tend to be reflected in a lesser degree of central co-ordination by the White House than is the case with Cabinet in the United Kingdom. Similarly the lack of a centralised civil service tradition in the United States has tended to lead to administrative decisions being taken


274 See part 6.3 of chapter 6.
in the context of adversarial courtroom-type procedures rather than by professional civil servants.

These differences in the relationship between the legislature and the executive in the United States and the United Kingdom carry certain consequences in terms of the use of delegated legislation and the degree of supervision exercised directly by the legislature in this area. Schwartz, in a study written in 1949 but which retains much of its essential validity, succinctly summarised the essential points of difference in this area.275

Furthermore, under the American system the federal judiciary has played a leading role in determining the requirements of regulatory decision making. Unlike the position in England, the US federal courts exercise wide-ranging powers of review in relation to all forms of significant administrative action. Decisions of regulatory agencies can be reviewed not only on the basis that they have violated statutory requirements (such as the public notification requirements in the US APA) but also because they appear to the court to be irrational or unreasonable. This process of judicial review often takes months, and sometimes years, and because of the need to allow the review process to take its course administrative policies and rules frequently become entrenched for prolonged periods. The other significant consequence is that regulatory decisions are often assessed against notional requirements of reasonableness applied in any particular case by judges who are unlikely to have specialist expertise in any particular area of the regulatory process.

275. Schwartz, Law and the Executive in Britain. A Comparative Study (Cambridge UP, Cambridge, 1949), pp 131-132: "The English laying procedure [i.e. the requirement that regulations be laid before Parliament] has, indeed, not been unknown in American practice. One example that readily comes to mind is the Reorganization Act of 1939, which gave the President extensive powers to reorganize the Executive branch of the Government. This measure passed only after bitter controversy and with the authority asked for by the President substantially cut down. The laying requirement was inserted as a check upon the power conferred; Presidential reorganization orders were not to be operative for a stated period during which they could be nullified by Congress.... This type of direct legislative supervision is, however, comparatively rare in this country. Control by Congress over the Executive tends rather to be indirect - through the prescription of certain requirements to which the Executive must conform. Although many similar requirements have been prescribed by Parliament, the American practice here goes much further. The Administrative Procedure Act of 1946 is an attempt by Congress to deal with the field as a whole and to prescribe certain minimum standards to which administrative procedure must conform."
However, these differences apart, there are also a number of similarities. There is frequently conflict between Cabinet and Parliament and in the United Kingdom it is an acceptable political tradition (perhaps more so in recent years) for backbenchers in Parliament openly, and sometimes trenchantly, to criticise the policies of their own party while it is in Government. It is not inconceivable for Parliamentary Select Committees to take a greater interest in certain aspects of the regulatory process than Cabinet might necessarily welcome or feel comfortable with. Topical examples in the regulatory area include recent Parliamentary inquiries into the subject of the remuneration of senior executives in the privatised utilities and into the functioning of the regulatory process in the financial services sector.

There are also significant areas of difference at the cultural level. American society is generally acknowledged to be more litigious and tales of far fetched US jury awards are the stuff of legend. The consumer movement and other interest groups are comparatively well funded and activist in their approach. These cultural features lend themselves to administrative processes of an adversarial nature, in which both industry and special interest groups play an active role.

It is probably fair to say that there is a greater average level of interest in and awareness of issues affecting business and its regulation than in the UK, where such interest tends to be more concentrated and restricted in scope. Such activism at the individual

276. Examples of this abound, including a jury award for US$5m for personal injury to a burglar injured while falling through the unsecured skylight of a school ceiling (after first prising it open), and the well publicised case of a woman who received US$600,000 after scalding herself with a cup of McDonald's coffee which fell from a precarious position into her lap while she was driving her car. For a description of these and other equally far-fetched examples see article in The Economist, 14 January 1995: "America's Litigation Explosion"; article in The Times, 12 March 1995: "Bless America - it's just given me £6m" (describing how one Francisco Marino, who fell on to the tracks of the New York Subway in a drunken stupor and was run over by a train, losing an arm in the process, was awarded US$9.3m (£6m) by a New York jury. Not surprisingly he shouted "God Bless America" as he left the courthouse.) On 15 July 1997 Jerold Mackenzie became one of Milwaukee's wealthier citizens (pending the outcome of an appeal) after a state court jury awarded him US$26.6m in damages against his former employer, Miller Beer, which dismissed him in 1993 for telling a questionable joke from the 'Seinfeld' television programme to a female co-worker. (For details of the case, and the joke, see the news item 'Miller Beer loses 'Seinfeld' Joke Case' on http://www.eonline.com/ News/Items/ 0,1,1450,00.html.)

277. There have been a number of sociological studies of this phenomenon, one of the more interesting being that of Wiener, English Culture and the Decline of Industrial Spirit, 1850-1980 (Penguin Books Limited, Harmondsworth, 1985).
level may of course have consequences which are not universally to be admired. United States regulatory processes can be accompanied by delays of up to five years or more in the finalising of agency rules. Particularly notorious examples of such delays occur in the environmental protection area, which is often a virtual battleground between developers and environmental groups.\textsuperscript{278} However, economic regulation can be no less adversarial, as Breyer has pointed out.\textsuperscript{279}

In the area of economic regulation the US regulatory agencies exhibit both similarities and differences compared with the corresponding UK regimes. As in the case of the UK regulatory bodies the US agencies are, at least ostensibly, politically independent. However, as has been discussed above, the US agencies are subject to both Congressional and Presidential oversight, both in terms of monitoring of their rule making functions and also in terms of the process of budgetary allocations.

In the United Kingdom such political influences as do exist are more covert and tend to operate largely behind the scenes. The present Government, for example, has been reluctant to be perceived as interfering directly in any substantial way with the regulatory process, particularly in relation to the activities of the privatised industries. Where Parliament has resolved to make its influence felt this has generally been done in less direct ways, such as through the National Audit Office or the work of Select Committees. The lack of any developed system of rule making in the field of economic

\textsuperscript{278} See the examples quoted in Wald, "Regulation at Risk: Are Courts Part of the Solution or Most of the Problem?" (1994) 67 S Cal LR 621 at 635-636. For a useful comparison between the United States and the United Kingdom of the effect of resort to adversarial procedures in the context of environmental regulation see Vogel, \textit{National Styles of Regulation. Environmental Policy in Great Britain and the United States} (Cornell University Press, NY, 1986), chapter 4.

\textsuperscript{279} See Breyer, "Regulation and Deregulation in The United States: Airlines, Telecommunications and Antitrust" in Majone (ed), \textit{Deregulation or Re-regulation? Regulatory Reform in Europe and The United States} (Pinter Publishers, London, 1990), p 9: "The net result of these institutional characteristics and tendencies is economic regulation that (1) tends to operate in an adversary relation with industry; (2) tends to be created and applied by a subject-matter-specific governmental administrative bureaucracy working somewhat independent of central control; (3) to a degree is developed through legal, courtroom type procedures, and (4) is embodied in legal rules that may seem somewhat inflexible and rather resistant to change. These institutional characteristics mean that regulatory systems cannot easily be 'fine tuned'; regulatory actions are cannons, not rifles. These characteristics also mean that different regulatory programmes have sufficient stability and common characteristics to warrant consideration as several distinct 'systems'. They have led some to characterise 'regulation' in general as a 'middle way' of relating government to industry, somewhere between 'nationalisation' and complete 'laissez faire'."
regulation has also removed a potential source of Parliamentary oversight along the lines of the American approach.

7.8.2 The Influence of Economic Factors

The differences identified above in the relationship between the legislature and the executive in the United States and the United Kingdom have certain discernible consequences in terms of the process of administrative rule making. Some commentators have sought to analyse these differences in terms of the underlying economic factors which influence the form and content of administrative rules. Posner, one of the better known US writers in this area, has sought to relate the process of administrative delegation to the degree of difficulty in passing statutory rules through the legislative process.

Posner's view, from a law and economics perspective, is that in a jurisdiction where the Executive is able readily to pass (or force the passage of) statutory rules through the legislative branch, there was likely to be a correspondingly lesser incidence of administrative rule making by regulatory bodies, as opposed to the use of formal delegated legislation such as statutory instruments or regulations issued under the auspices of the Executive. In his view this served to explain the comparatively greater popularity of administrative rule making in the United States compared with the United Kingdom.280

Other commentators have taken a similar view, pointing for example, to the way in which the executive and the civil service under the British system constitute a co-

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280. Ehrlich and Posner, "An Economic Analysis of Legal Rule Making" (1975) 3 J Leg Studs 257, 267-268: "Transaction costs tend to increase rapidly with the number of parties whose agreement is necessary for the agreement to occur. This suggests that there are practical limits to increasing the size of a legislature. Hence... as the amount and complexity of social activity increase over time, we can expect to find that legislatures, rather than expanding, will delegate more and more of the legislative function to bodies that do not produce rules through negotiation among a large number of people - i.e., to executive and administrative agencies and to courts - as has in fact happened. We are similarly led to predict that delegation will be less common in systems (such as the British) where party discipline in the legislature is tight and the legislature is (effectively) unicameral; both circumstances reduce the costs of arriving at agreement on legislation." Posner expands on these views in the latest edition of his text on law and economics. See Posner, Economic Analysis of Law (Little, Brown & Co, Boston, 4th ed, 1992), chapter 20.
ordinated system of parallel control, under which Cabinet Ministers rarely set about duplicating the detailed analysis already carried out by the civil service through the various government departments. This in turn gives rise to different control structures. In the United Kingdom a horizontal control structure, with Ministers acting on the recommendations of sponsoring departments, can be contrasted with the United States system, where a strong central body exercises oversight and authority over less powerful agencies, as Baldwin and Veljanovski have noted.281

The validity of this analysis may be somewhat lessened now that the role of the civil service has itself been redefined in the era of the Next Steps agencies and the growth of privatisation has seen the evolution of industry-specific regulatory bodies. Nevertheless it remains the case that the passage of legislation through the United Kingdom Parliament is, in general, a more straightforward exercise than the corresponding process in the case of the US Congress. This tends to reinforce the conclusion that the incentive to circumvent or avoid the complexities of grappling head-on with the legislative process will be greater in the United States than in the United Kingdom. In turn this may serve to explain, at least to some extent, the greater popularity of administrative rule making under the US system, although other factors such as the existence of the APA and the historical influence of the institutional structures established during the New Deal era are clearly also significant.

7.8.3 The Application of Capture Theories of Regulatory Behaviour in the United Kingdom

(i) Introduction

This part of the chapter considers the application in the United Kingdom context of the theories of regulatory behaviour referred to in part 6.3 of chapter 6. To begin with

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281. Baldwin and Veljanovski, "Regulation by Cost-Benefit Analysis" (1984) 62 Pub Admin 51 at 65: "In fact the British cabinet secretariat does not attempt such review [of recommendations put up from government departments] and far from exercising minute control, operates at the level of the most general policy. The departments are the sources of policies which are not scrutinised in detail. The British system of delegating policy-making downwards thus lends itself to the imposition of CB [Cost-Benefit] testing from above far less readily than does a system that is already attuned to control through a vertical hierarchy as in France or the US... Overview systems in Britain tend to duplicate functions without matching departmental expertise."
capture theories, based on the pervasive influence of industry on the regulatory process, the three types of regulatory capture have been discussed in that chapter. These are the pro-industry appointments hypothesis, the securing of budgetary incentives by favourable industry treatment and the use of industry job incentives.

As a matter of strict theory it might be considered an easier task to "capture" a regulator in the form of a single individual (as in the case of the regulatory regime for the UK privatised utilities) than a corporate regulatory body in which the decision making processes may require the consensus of several commissioners. However in practice there is little if any evidence of capture in the United Kingdom regulatory scene.\(^{282}\)

(ii) The Privatised Utilities

In the case of the privatised utilities the individual regulators have shown little tendency to favour the regulated interests. As the discussion earlier in this chapter has shown\(^{283}\) the reverse has often been the case in that the regulators' actions, particularly in the case of electricity and gas, have frequently been the subject of criticism (and even outrage) within the regulated industries and have also led to more than one MMC reference.

The regulators themselves have generally been concerned to demonstrate individual professionalism and adherence to the norms of economic theory, particularly in the case of Professor Littlechild and Ms Spottiswoode. The electricity regulator in particular, having come from a background of academic scholarship and published work in the area of economic regulation,\(^{284}\) has demonstrated this professional interest in his

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282. Perhaps the example which has come closest to approaching regulatory capture in recent times has been the OFLOT saga described in the text accompanying notes 4-8, supra.

283. See part 7.4.6 to this chapter.

regulatory capacity. One recent example has been his emphasis on the need for regional electricity companies to attain efficiency in their operations, with the threat of possible takeover acting as an incentive towards this end if necessary. While this economic philosophy may coincide with the interests of the regulated companies in some areas it clearly does not in others. The electricity regulator's actions in March 1995 in suggesting a need to revisit the pricing regime to the detriment of the regional electricity companies and their shareholders, as discussed in part 7.4.6 (iii) of this chapter, was another example of this.

Similarly, in August 1995, the Government ignored concerns expressed by the electricity regulator in relation to the reference of industry takeover bids to the MMC. A hostile £1bn take-over bid by ScottishPower for Manweb (the regional electricity company for Merseyside and North Wales) generated sustained lobbying in favour of an MMC reference, a course which was supported by Professor Littlechild. However the regulator was not supported in this view by the Office of Fair Trading and the Government allowed the bid to proceed without the need for an MMC reference. This followed the Government's rejection earlier in 1995 of the regulator's recommendation that another hostile takeover bid, the offer made for Northern Electricity by the Trafalgar House group, be referred to the MMC.

It has been claimed that regulatory independence and the vesting of wide discretionary powers in the regulators are necessary in order to minimise the risk of the regulatory process favouring industry groups and to diminish the risk of regulatory capture. Such

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285. See article by Melvyn Marckus in *The Times* of 12 August 1995, p 22, "Master of the Megawatt strikes again" who quotes Professor Littlechild as having then recently stated: "The possibility of takeover achieves the desired end more easily. If the incumbent management...is failing to operate efficiently, the takeover bid is precisely the means whereby a more efficient management can replace it."

286. See article in *The Times*, 1 September 1995: "Electricity bids win surprise go-ahead"; article in *The Times*, 1 September 1995: "President sets a precedent".
a view has been expressed by certain economists, including Sir Christopher Foster.287
The editor of the *Economist* has expressed a similar view.288

Drawing the line between adequate autonomy of action and the preservation of a reasonable degree of Parliamentary accountability is never an easy task. While it may be true to say that regulatory independence does provide a safeguard against the risk of industry capture, such a goal is not the only one which an ideal regulatory regime needs to meet. The most efficient form of Government may well be a dictatorship but few people (aside from aspiring dictators) would espouse the goal of efficiency in this context above everything else.

(iii) Rail and Air Transport

In the case of rail transport, the Rail Regulator Mr John Swift QC, a respected senior barrister, has also shown little tendency to be unduly influenced by the rail industry itself. The papers issued by the Office of the Rail Regulator reveal a concern with applying the statutory criteria to the regulatory task and the regulator's public pronouncements have shown that he takes the independent nature of his position seriously.289

In relation to air transport, the study by Baldwin of the operations of the CAA during the mid 1980s also revealed little or no evidence of regulatory capture by airline industry interests, despite the structural similarities between UK and US regulation in


288. See "Monopoly prophets - What the world's privatisers can learn from Britain's disposal of its state-owned utilities", *The Economist*, 24 July 1993, p 18: "But where a regulator is needed, his independence must be tempered by accountability - especially to consumers. Britons need an easier route of appeal over the heads of individual regulators to their national competition authority. That done, the British system may still be better than its alternatives. It has long been argued that the greatest threat to any system is 'regulatory capture'. Political regulators have been subverted by the lobbying of big industries. Legalistic regimes have bent under the weight of a regulated industry's superior resources, which have given it the edge when decisions are challenged in the courts. Independence - within limits - is the best defence against this sort of capture."

289. See the discussion in part 7.6.1 (iv) of this chapter.
this area.\textsuperscript{290} In his study of civil aviation regulation, Baldwin considered the three main hypothetical arguments which might form the basis of any allegation of industry capture of the CAA.

The first such argument was identified by Baldwin as being the fact that agency decisions were based on information supplied by the airline industry and that only the interests of the industry were represented at formal proceedings.\textsuperscript{291} Baldwin in fact found that CAA decisions not only originated from formal hearings but could also arise from several different procedures, including the analysis of collected statistics and from the use of computer modelling techniques. He thought that there was an even stronger case against the existence of regulatory capture in relation to public consultations and CAA rule making as these processes generally involved data derived either from joint research with the airlines or from the Authority's own work. Baldwin also pointed to the increased involvement of consumer interests in the civil aviation regulatory process in recent years concluding as follows.\textsuperscript{292}

The second argument analysed by Baldwin was the familiar industry appointments hypothesis, based on the premise that individuals appointed to high regulatory office would conceivably identify with industry interests with a view to possible future employment, or because of loyalties generated out of past employment in the airline industry.\textsuperscript{293} In considering this argument, Baldwin looked at the background and careers of previous chairmen of the Authority and at other senior officials in the CAA and again found little evidence of regulatory capture.\textsuperscript{294}

\begin{enumerate}
\item \textsuperscript{290} See Baldwin, \textit{Regulating the Airlines}, supra note 208, chapter 12.
\item \textsuperscript{291} For a discussion of this argument see \textit{ibid} 220-225.
\item \textsuperscript{292} \textit{Ibid} 224-225: "To summarize the first argument for capture, we may say that although raw data comes from the airline industry, there is considerable self-generation by the CAA and that this acts to counter any dependence: this is especially the case outside the formal public hearing. As far as the representation of non-airline interests is concerned, there have been grounds for criticism in the past, but, given improved access to information, the AUC [Airline Users Committee] system does offer limited consumer input into both licensing hearings and the wider consultative process."
\item \textsuperscript{293} For a discussion of this argument see \textit{ibid} 225-230.
\item \textsuperscript{294} \textit{Ibid} 230: "Once more it has to be concluded that the argument for capture - this time by the assimilation of airline interests via key CAA personnel - has yet to be made in terms either of the career interests of those persons or of the policies they have pursued."
\end{enumerate}
Finally, Baldwin examined the argument that a regulatory agency such as the CAA would be likely to be deferential to the wishes of the regulated industry by reason of express or implied threats of political repercussions or of resort to crippling use of the judicial process by way of protracted and expensive appeals and judicial review proceedings. He found this argument similarly unconvincing.

Given the more limited scope of judicial review of regulatory decision making in the United Kingdom as compared with the United States and the absence of the appellate processes which often arise out of US regulatory hearings it is perhaps unsurprising that Baldwin found that the third argument advanced in favour of regulatory capture was of limited relevance in British experience. Finally, the deregulated environment now prevailing in relation to air transport, particularly within the EU, would seem to reduce the scope for regulatory capture in this sector even further.

(iv) Financial Services

Turning now to the self-regulatory regime applicable to financial services, the considerations here are somewhat different. In one sense of the term, the financial services regulators are already 'captives' of the industry in that the system of recognised bodies established under the Financial Services Act 1986 acknowledges the role of industry membership of the self regulating bodies. Nevertheless, there is ample evidence to suggest that bodies such as the SIB take their regulatory role seriously and exercise their powers with considerable independence. The use of stringent disciplinary measures, such as the imposition of fines and suspensions, has been referred to earlier.

While there is undoubtedly considerable input from members of the financial services industry into the form and content of the industry's rules, the industry is one which


296. Ibid 231: "The argument of 'capture by threat' must, for the present, be deemed unconvincing: few CAA decisions have so far been overruled on appeal and no decision of the CAA has been successfully challenged in any court of law."

297. See the text accompanying note 257, supra.
attracts considerable public and political scrutiny and also plays an important role in the United Kingdom economy. A self regulatory regime which is unduly favourable to industry interests does not appear to have emerged in the United Kingdom context, despite periodic criticisms that the system lacks sufficient teeth in terms of providing adequate control over the activities of individual financial services practitioners.298

(v) The Application of Capture Theories - A Summary

Looking generally at the sphere of economic regulation in the United Kingdom, there is little evidence to suggest that regulatory capture has occurred to any significant extent. In the case of the privatised utilities, the prevailing criticism is in fact that the regulators have exercised too much independence, rather than not enough. The same can be said about the regulation of rail transport. In the case of air transport regulation there is again little evidence of the existence of any capture phenomenon, despite the fact that regulation of the airline industry is effected through a similar corporate form to that used in the United States, from which capture theories originated. Finally, in the case of the self regulatory regime applicable to the financial services industry, the industry regulatory bodies generally appear to have taken an independent stance in relation to their regulatory responsibilities.

These conclusions are to be anticipated to some extent given the cultural and institutional differences identified at the beginning of this part of the chapter. There is at present much more limited scope in the United Kingdom for use of the judicial process in relation to regulatory decision making. Instances of successful judicial review applications against UK regulatory bodies operating in the economic field are comparatively rare. Members of a regulated industry therefore have much more limited scope for threatening use of the judicial process as a way of restraining regulatory action.

298. Such criticisms not infrequently surface in the wake of the periodic financial disasters and corporate crashes which afflict most Western market economies, with the United Kingdom being no exception. See the text accompanying note 256, supra.
At the political level, industry bodies have sometimes been seen to sidestep the regulator rather than endeavour to capture him or her, with the telecommunications industry providing a recent example.\textsuperscript{299} This remark is of course made in the context of the current political climate in the United Kingdom. A change in government, which might possibly be accompanied by a more interventionist political attitude towards industry, might well lead to increased political pressure being brought to bear on a regulator to adopt a particular policy course.

7.9 The Relevance of UK Competition Law and Institutions

7.9.1 The Relationship between Competition Law and Economic Regulation

Some brief reflection will serve to show the close correlation between competition law principles and the shape of economic regulation. If the attributes of the ideal regulatory regime, as discussed in chapter 1, are considered in this context, then the inter-relationship between these two areas becomes evident.

To begin with the goal of certainty, principles which are clearly formulated in general competition legislation may assist in achieving the goal of regulatory certainty. The goal of accessibility can similarly be assisted by procedures contained in the general competition law, particularly where this specifies participatory mechanisms such as public inquiries or similar mechanisms.

Competition law can also have an obvious role to play in terms of achieving the goal of effectiveness. The provision of adequate penalties for anti-competitive behaviour, together with the availability of enforceable third party rights, can greatly enhance the effectiveness of a potential regulatory regime.\textsuperscript{300} Similarly, the availability of effective competition law remedies in the context of clear legislative objectives in this area can promote the efficiency, accuracy and fairness of a regulatory regime.

\textsuperscript{299} See part 9.6.10(i) of chapter 9 dealing with the lobbying strategy adopted by BT in an endeavour to bring pressure to bear on OFTEL to abandon its proposed fair trading condition.

\textsuperscript{300} The discussion in chapter 9 of the OFTEL regulatory regime shows that recent regulatory initiatives by the Director General of Telecommunications have been closely related to perceived areas of weakness in current UK competition law.
This is particularly the case in relation to areas such as network interconnection and the use of essential facilities.

The goal of enforceability is also of relevance here. Where a regulator can have recourse to penalties and sanctions provided for in the general competition law this can render a regulatory regime more effective in practice. Finally the provision of clear legislative guidelines as to the functioning of competitive markets can promote the accountability of regulators to the objectives set by Parliament.

The structure of existing UK competition law has exerted considerable influence on the shape of economic regulation in the UK to date, especially compared with the EC position. In particular, the comparative lack of enforceable sanctions for abuse of a dominant market position (a situation which, by way of contrast, is the subject of stringent provisions in Articles 85 and 86 of the Treaty of Rome) has led some UK regulators to introduce their own initiatives to remedy this deficiency. This has been most evident in the telecommunications area, where OFTEL has recently introduced a licence condition dealing with anti-competitive behaviour which incorporates reference to EC practice in this area and which seeks to confer powers on the regulator which are otherwise absent from the UK competition law regime.

The rail regulator has also sought to incorporate conditions in rail passenger operating licences dealing with anti-competitive behaviour. In the civil aviation context the move towards a single market based on the Third Package of EC air transport regulations has exerted its own influence on the air route licensing area.


302. See the discussion in parts 9.6 to 9.7 of chapter 9.

303. See the discussion in part 9.6.10(iii) of chapter 9.

304. See the discussion in part 7.6.2(ii) of chapter 7.
The CAA also has power to counter anti-competitive behaviour in the industry, as was noted earlier in this chapter.305

UK competition legislation has been the subject of criticism by various commentators based on its comparative complexity, cumbersome structure and lack of enforceable sanctions.306 Some commentators, including the outgoing Deputy Director General of Fair Trading, would add unpredictability to this list of failings.307 The UK position is particular anomalous given its lack of alignment with European community law. One of the central areas of criticism has revolved around the two-tier structure comprised of the Office of Fair Trading (which has various investigative powers but limited enforcement capability) and the MMC (which is characterised by relative complexity of procedure, non-binding recommendations and limited requirements of consistency with prior decisions).308

305. See the discussion in note 224, supra.

306. For a useful discussion of some of the perceived shortcomings see the recent paper by Sir Bryan Carsberg, formerly Director General of Telecommunications from 1984-1992 and Director General of Fair Trading from 1992-1995, *Competition Regulation the British Way: Jaguar or Dinosaur?* (IEA for The Wincott Foundation, Occasional Paper 97, London, 1996). In his paper Sir Bryan Carsberg pointed to the complicated structure of the competition legislation (noting that the functions of the Director General of Fair Trading were to be found in some 20 different statutes), the absence of adequate deterrents for anti-competitive behaviour especially compared with EC law, and the perceived need for a single competition authority with adequate jurisdiction. See also the discussion in Lever, "UK Economic Regulation: Use and Abuse of the Law" (1992) 13 ECLR 55; Hutchings, "The Need for Reform of UK Competition Policy" (1995) 4 ECLR 211; Pratt, "Changes in UK Competition law: a wasted opportunity" in Lonbay, *Frontiers of Competition Law* (Wiley Chancery Law Publishing in conjunction with the Institute of European Law, University of Birmingham, London, 1994).

307. See Dr Howe, "Competition policy: where next?" (Speech by Dr Martin Howe, outgoing Deputy Director General of Fair Trading, OFT, London, 26 February 1997, summary of the text on the internet at web site page http://www.open.gov.uk/ofr/frames/wherenex.htm): "How to deal with market dominance is a more controversial subject. Ambitious and innovative companies may build up market dominating positions and it would be counter-productive to blunt managerial incentives. The aim is to prevent the exploitation of market power and those practices of dominant firms which restrict or prevent competition. The Government's position is to continue with a law which is, as Dr Howe puts it, 'wide-ranging in its scope but inherently unpredictable in its impact'. It is also, as Dr Howe comments, quite different from Article 86 and the law in other EU countries." (Text from the internet version.)

308. For a useful summary of the structure of UK competition law in the present context see the helpful publications by the Office of Fair Trading, *An Outline of United Kingdom Competition Policy* (OFT publication 0032, HMSO, London, November 1993); *Monopolies & Anti-competitive Practices* (OFT publication 0126, HMSO, London, March 1995). The basic structure of UK competition legislation is set out in the standard competition law texts such as Whish & Sufrin, supra note 75.
From time to time proposals for reform of UK competition law have been suggested, although to date they have made little forward progress. The issue of abuse of market power was addressed in a 1989 White Paper \(^{309}\) and subsequently in a 1992 Green Paper.\(^{310}\) The government was not convinced of the need for an Article 86 type of prohibition and proposed instead to confer stronger investigative powers, together with power to make interim orders, on the Director General of Fair Trading. This approach has recently been confirmed in a Department of Trade and Industry consultation document issued in March 1996, which invited comments on the issues raised in the paper by 1 May 1996.\(^{311}\)

In relation to abuse of market power, the consultation paper maintained the approach set out in the 1992 Green Paper that the current system ought to be strengthened rather than introducing an Article 86 style prohibition.\(^{312}\) However, the paper recognised that individual cases, such as OFTEL's arguments that a specific licence condition dealing with anti-competitive behaviour should be inserted into telecommunications licences, would still need to be addressed in the context of specific industry legislation such as that establishing the public utilities.\(^{313}\)

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312. *Ibid* para 9.11: "Accordingly the Government's present view is that the balance of advantage lies with strengthening the current system rather than introducing a prohibition. The Government remains committed, in reforming legislation dealing with anti-competitive agreements, to take the opportunity additionally of strengthening the Fair Trading Act and Competition Act and its view remains that the introduction of a prohibition of abuse of market power for the economy at large should not at this stage be pursued."

313. *Ibid* para 9.13: "The position of regulated utilities is quite distinct from the position under general competition law. The purpose of many of the licence conditions and specific regulatory oversight has been to nurture competition in what initially was an unpromising environment developing out of a total monopoly. Such cases need to be considered individually. The Government recognises that, against this background, OfTEL has come forward with vigorous arguments to support its view that there needs to be a form of prohibition to be written into licences in the telecommunications sector and its view that this
The consultation paper has recently been followed by a draft bill issued by the Department of Trade and Industry in August 1996. The Department invited comments on the draft bill by 1 October 1996. In relation to abuse of market power, the Department noted that support for an Article 86 type of prohibition was evenly balanced with the Department's proposal to strengthen the existing legislation. The EC style approach was heavily supported by consumers representatives, members of the legal profession and a number of businesses. Significantly, the latter included a number of companies in the telecommunications sector. More recently there have been moves to extend the application of Articles 85 and 86 to the UK air transport sector. It is likely that such initiatives will continue over the medium term, even in the absence of formal adoption of Articles 85 and 86 into UK domestic law, a trend which has been recognised by the present Director General of Fair Trading.

broad approach is more effective than adding to licence conditions addressing specific anti-competitive behaviour. In principle such a prohibition of abuse of market power (a form of which has already been inserted as a condition into some other telecommunications licences) would be an extension of these specific conditions which already exist in BT's licence, such as prohibition of cross-subsidy or non-discriminatory requirements which are aimed at promoting competition or curtailing abuse. Enforcement of the licence condition would be through the powers given to the Director General of Telecommunications by the Telecommunications Act 1984."


315. It is interesting to note that the Trade and Industry Select Committee has recently expressed itself as being in favour of a prohibition approach along the lines of the EC system. See *UK Policy on Monopolies* (Fifth Report of the Trade and Industry Select Committee, Session 1994-95, HC 249-I, HMSO, London). The Committee's report is noted in Fraser, "Monopoly, Prohibition and Deterrence" (1995) 58 Mod LR 846.


317. See the EC Competition Law (Articles 88 and 89) Enforcement Regulations 1996 (made on 23 August 1996). Articles 88 and 89 set out provisions for the implementation by member states of Articles 85 and 86. The effect of these regulations, is discussed in a speech by Mr Peter Rostron, Assistant Director, Legal Division, OFT, 26 September 1996, "The implementation of EC competition law by national anti-trust authorities". (Speech given at the 15th International Anti-Trust Law Conference, Oxford, text on the internet at web site page http://www.open.gov.uk/oft/anti.htm).

318. See Bridgeman, "Current directions in competition policy" (Address by Mr John Bridgeman, Director General of Fair Trading, delivering the Lord Fletcher Memorial Lecture to the Law Society, London, 4 December 1996, text on the internet at web site page http://www.open.gov.uk/oft/frames/sp-flet.htm): "Clearly, the more that that happens the greater will be the tendency for EC and national authorities to monitor each others' decisions
On this issue, the Department expressed a concern that an approach based on an Article 86 type of provision might be unduly inhibiting to business as opposed to the Department's preferred approach. The MMC itself has said that any changes need to be carefully evaluated. Given that common law jurisdictions in most of the rest of the world (including the United States, Canada, Australia, and New Zealand), together with the European Community, have had little difficulty in coping with anti-trust or competition laws which serve to prohibit abuse of a dominant market and work towards a homogeneous body of EC and national case law. Indeed the draft bill which the UK Government has just failed to introduce explicitly requires courts to follow EC jurisprudence. The Commission has not finished with its attempt to induce national authorities to enforce the Treaty provisions. But the British view is that this indiscriminate approach is flawed, and I must say I agree. I think that reform of national laws is clearly the reasonable way forward, and will lead to harmonisation. But I also think that a need for harmonisation will not be the prime driving force for Member States' reforms - and my French and German counterparts agree with me."

Ibid para 19 on p 128: "On the first question we remain concerned that the risks of inhibiting genuinely competitive behaviour may outweigh the potential benefits of greater deterrence that a prohibition system might bring. It is clearly important that we should not introduce a prohibition if its application is uncertain and if uncertainty coupled with potential exposure to penalties and third party claims causes companies in, or arguably in, a dominant market position to 'aim-off', acting more cautiously. This could damage genuine competition and the exploitation of innovation."

See MMC Annual Review for 1995, (MMC, London, 24 January 1996). The MMC Chairman, Mr Graeme Odgers, in the accompanying press release, noted: "There have been calls for the monopoly provisions of the Fair Trading Act to be replaced by a prohibition-based system on the lines of Article 86 of the Treaty of Rome. Proponents of such a system have argued that it would provide an increased deterrent to anti-competitive behaviour and an effective means of dealing with predatory activity. Opponents on the other hand, argue that under such a system the difficulty of deciding what is or is not an abuse might lead to pro-competitive behaviour being discouraged. Also, an Article 86-type system could result in more involvement of the courts, which may not be best suited to resolve economic issues related to market definition, dominance and abuse of dominance. They argue further that such a system is not as well adapted to dealing with oligopolistic market structures as is the Fair Trading Act with its provision for dealing with complex monopolies...These ideas for reform go to the heart of our long established competition regulatory philosophy and structure. They need careful and rigorous evaluation." (See MMC press release 2/96, 24 January 1996, text on the internet at http://www.coi.gov.uk/depts/GMM/GMM.html.) Mr Odgers pursued a similar theme in the 1996 MMC Annual Review: "Deciding the competition policy framework best suited to the UK economy is a vital matter for any Government. While it is clear that reform of the existing Restrictive Trade Practices Act is called for, the case for major changes to the Fair Trading Act is less clear. However, the current basic framework has been in place for many years and I welcome the debate, and the recognition by all political parties, that a review is timely." (See MMC press release 2/97, 6 February 1997, text on internet at above web site page.)

position, the Department of Trade and Industry's reticence in this area was somewhat difficult to understand.

Prior to the recent general election it seemed that it might be some time before UK competition law would incorporate effective and enforceable procedures which are taken for granted in much of the rest of the world, although the DTI report appeared to leave open the possibility of such an approach being adopted in the future. Any legislative initiatives in the near future seemed doubtful and the draft Competition Bill issued in 1996 was not included in the Queen's Speech. However, since the election, the Director General of Fair Trading has issued a draft Competition Bill which seeks to harmonise UK and EC competition law and which introduces a right of action for damages for anti-competitive conduct.

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322. See DTI Draft Bill, supra note 314, para 21: "None of the approaches suggested is as yet sufficiently worked up to the extent of resolving all the problems so far identified. It is by no means clear at this stage that a prohibition based approach for the economy at large can be made to work satisfactorily. However, we have concluded that the options merit further consideration. We therefore wish to promote further public debate on the issues raised, and in particular views on the case for a more limited, tightly defined prohibition would be welcome. In particular we would need to ensure that it is only abuse of market power not genuine competitive behaviour which is deterred, that the system developed is not burdensome on companies, that it does not create the potential for undue litigation and that it is capable of being enforced by the DGFT effectively. Given the importance of assessing this through public consultation, it does not seem that it is either practical or desirable to seek to implement any such approach by incorporating it in the legislation this autumn. If the case can be established for more radical reform, it would need to be implemented subsequently."

323. The Director General of Fair Trading summed up the position in a recent speech given on 3 December 1996 as follows: "You may be aware that the Government has been considering changes to some of this legislation for some time. A draft Competition Bill was published in August but to my disappointment, there was no mention of the Bill in the Queen's speech. The Government intends to press ahead with reform but there seems little chance of new legislation in the foreseeable future. Nevertheless I hope a Bill will be brought forward at the first opportunity." See John S Bridgeman, Speech to the Conservative Backbench Trade and Industry Committee, "Championing competition, and the consumer" (3 December 1996, text on internet at web site http://www.open.gov.uk/off/sp-tory.htm).

324. See article in The Times, 15 May 1997: "Consumers can sue over issues of competition"; article in The Times, 8 August 1997: "Firms to face huge fines as MMC goes." The proposed legislation, which introduces provisions along the lines of Articles 85 and 86 into UK competition law and provides for fines of up to 10% of a company's annual turnover for breaches of competition law, is not likely to take effect before October 1999.
7.9.2 The Role of the MMC

The possibility of a review by the Monopolies and Mergers Commission (MMC) of certain decisions of regulators in the economic area was noted earlier in this chapter.\textsuperscript{325} In relation to the gas industry the MMC has undeniably played a pivotal role in relation to the development of competitive structures (although in the example of gas the process was undoubtedly somewhat confrontational in nature). Compulsory MMC referrals under the Water Industry Act 1991 in relation to water company mergers, where the assets subject to the merger proposals have been valued at more than £30m, have also played a key role in structuring the ownership of water utilities. The MMC has also played a role in relation to the revision of licence conditions in the electricity supply industry, as Jasinski has noted.\textsuperscript{326} However this process has been thought by some commentators to be excessively bureaucratic in nature, involving as it does lengthy discussions and negotiations among the industry participants, the regulator and the MMC.\textsuperscript{327}

The availability of a reference to the MMC from decisions of the industry regulators is something of a two-edged sword. From a regulated company's perspective such a right of review may be beneficial in that the company has the right to demonstrate to another tribunal that a particular regulatory decision should not be affirmed as it is either


\textsuperscript{326} See Jasinski, \textit{Competition in the Electricity Supply Industry} (Regulatory Policy Research Centre, Hertford College, Oxford, Working Paper No 4, October 1994), p 23: "The cornerstone of economic regulation UK-style is the price cap 'RFI-X', which we shall discuss in detail later. This is enforced by the regulator and modified in agreement with the industry, or in absence of this, by referral to the MMC. The MMC acts as an 'appeal court' for licence revision and resetting of the price cap. The reference is usually on grounds of general public interest reference rather than a narrow determination of the issue in dispute and the managers of regulated utilities are usually keen on avoiding referral because of, as they themselves say, the lost time that a full scale reference would entail. Moreover, and far more to the point, after the MMC report has been published, the regulator can change the licences so as to remedy the detriment to the public interest, but he is not required to accept the recommendations specified by the MMC. That is why implicit regulation ... ie the very threat of - or the risk of triggering - both a regulatory intervention and a referral to the MMC have themselves powerful disciplining effect and play such an important role in the British regulatory system."

\textsuperscript{327} See Baldwin, "Mergers and Water Regulators" (1990) 1 Util LR 69; article in \textit{The Times}, 1 April 1995: "Water bid referred to MMC" (dealing with a possible takeover bid for Northumbrian Water by Lyonnaise des Eaux of France).
unreasonable or will not further the objectives sought to be achieved. Conversely however, a regulatory decision can become entrenched through confirmation by the MMC and the company seeking the review takes the risk that the MMC may in fact adopt a more stringent approach than the industry regulator. In such a case the outcome of an MMC reference might well prove to be even less favourable from the perspective of the party which has sought the review. (Any criminal lawyer who has weighed up whether or not to advise a client to appeal against a sentence, and risk being given a longer jail term, will be familiar with this dichotomy.)

The availability of a reference to the MMC can also serve as a systemic check on an over-zealous regulator as well as providing a means of remedying an irrational regulatory decision. The extent to which the Government of the day can influence MMC decisions is the subject of some debate among the commentators. Craig, for example, recognises that while the MMC is not a government department as such, it may still be amenable to some degree of external political influence.328

MMC review, particularly in relation to modifications in licence conditions in the electricity and telecommunications sectors, may also allow greater scope to the regulated company to challenge the decision by way of judicial review. The MMC publishes a written decision whereas, at first instance, there is no explicit obligation on the industry regulators to issue written decisions, therefore making judicial review more difficult. This is a feature of the regulatory regime which is open to criticism. However, the courts have been prepared to allow some degree of flexibility in practice in the procedural requirements for challenging regulatory decisions.

For example, the House of Lords in its judgment given in February 1995 in proceedings between Mercury Communications Limited and the Director-General of Telecommunications,329 was willing to permit Mercury to challenge a decision by the

328. Craig, supra note 22, p 217: "It would be wrong to assume that the government can in a literal sense dictate to the MMC the type of view which it should adopt on the meaning of the 'public interest'. It would also be wrong to assume that the fact that the government does exercise some power in this respect is 'wrong'. The legislation upon competition is structured to leave discretion and ultimate control in the hands of the minister. Competition, like planning, is regarded as an area which cannot be completely divorced from political considerations, and one where some executive control is required."

329. See Mercury Communications Limited v Director General of Telecommunications (House of Lords, 9 February 1995, reported in The Times, 10 February 1995, and on LEXIS).
Director-General based on the construction of BT's licence conditions by way of an originating summons seeking a declaration, rather than pursuant to the judicial review procedure under Order 53 of the Rules of the Supreme Court. The House of Lords noted that the interpretation of the relevant condition in BT's licence arose in the context of a commercial dispute between Mercury and BT and that dispute, both in substance and in form, concerned the contractual effect of the relevant licence conditions, so that it was appropriate for Mercury to seek a declaration in the Commercial Court, rather than judicial review under Order 53. Such an approach helps to avoid the technical difficulties often inherent in the Order 53 procedure.

The Commission itself presently consists of a Chairman (Graeme Odgers, a businessman and company director), three Deputy Chairmen (Peter Dean, a solicitor, Dan Goyder, a solicitor and competition law expert, Derek Morris, an economist) and 31 other members. There is also an Electricity Panel (6 members) a Newspaper Panel (7 members), a Telecommunications Panel (3 members) and a Water Panel (3 members).330 The MMC review procedure is limited, in that it is not available as of right in all circumstances to companies adversely affected by a regulatory decision. The question of whether or not an appeal on the merits against the decisions of economic regulators should be conferred (as opposed to a right simply to seek judicial review in accordance with the recognised criteria for that remedy) remains an ongoing area of debate.

An examination of the system of economic regulation in the United States reveals that in general there is no right of appeal on the merits to an appeal authority or other body of higher status than the independent regulatory commissions. In US practice, the commissions are taken to possess considerable expertise in their particular areas of operation. However the remedy of judicial review remains available. As has been seen in chapter 6, the boundaries of this remedy are less clearly defined than in the United Kingdom and its potential scope of application is wider. Some US courts have shown greater willingness than others to embark on a review process which seems to a British observer to be suspiciously close to an appeal on the merits against a regulatory

330. For biographical details of these members see the MMC web site page http://www.open.gov.uk/mmc/law_biog.htm (page last updated on 11 November 1996).
decision. Indeed, if a 'hard look' approach to judicial review is vigorously pursued, then the end result may not differ greatly in practice from an appeal on the merits.\textsuperscript{331}

In the United Kingdom, opinions differ as to whether an appeal on the merits against regulatory decisions should be confined or extended beyond the level to which such an appeal is permitted under the present system. Those who support the concept of an appeal on the merits are often not unanimous in the view that the MMC is the most appropriate body to hear such an appeal. Part of the difficulty is that the MMC procedures were developed to handle situations involving some degree of complexity, such as evaluating the merits of mergers and takeovers, and are not necessarily well suited to all forms of regulatory appeal.\textsuperscript{332} While many regulatory disputes undoubtedly involve matters of some complexity this is not always the case. These issues will be canvassed in more detail below.

7.9.3 The advantages and disadvantages of an appeal on the merits

Those who support the existence of a right of review or appeal on the merits have pointed to several claimed advantages for such a procedure. To begin with, given the existence of a system of single industry regulators in the privatised utilities who are invested with considerable discretionary powers, an appeal to a body such as the MMC, under certain defined circumstances, can be seen as providing a mechanism for limiting and controlling the exercise of such powers. In one sense the present regulatory framework does not have any right of appeal in the true sense of the term, as the issue of what action should be taken to implement an MMC decision remains a matter for the Regulator to determine, although the Regulator is bound to have regard to any

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\textsuperscript{331.} See part 8.3.6(iii) of chapter 8.

\textsuperscript{332.} For a discussion of the role of the MMC in the area of takeovers and mergers in the United Kingdom see Craig, "The Monopolies and Mergers Commission: Competition and Administrative Rationality" in Baldwin and McCrudden (eds), \textit{Regulation and Public Law}, \textit{supra} note 1. For a general discussion of the role of the MMC in relation to monopoly references and anti-competitive practices, see Whish and Sufrin, \textit{supra} note 75, chapter 3; Office of Fair Trading, \textit{Monopolies & Anti-competitive Practices}, \textit{supra} note 308; Office of Fair Trading, \textit{Mergers} (OFT publication 0036; London, October 1995); Monopolies and Mergers Commission, \textit{The Role of the MMC} (MMC publication, London, 24 October 1996).
modifications recommended by the MMC in its report. In the case of rail transport the right of MMC review does not extend to the terms of approval of track access agreements under s17 of the Railways Act 1993. Approval of these agreements rests with the Rail Regulator, who has designed a special approval procedure for this purpose which will be discussed in chapter 9.

Another perceived advantage of an MMC appeal is that the issues in question can be brought out into the open and the MMC can embark on a broader analysis of the matters arising if it so chooses, although in practice it has so far proved reluctant to adopt such an approach. In circumstances where relations between the regulated company and the regulator have either broken down or are somewhat fraught, the MMC procedure has also been perceived as a means of taking some of the heat out of such a situation, while ensuring that justice in regulatory decision making is not only done but also seen to be done. Whatever other faults it may have, the MMC procedure is undoubtedly one which is open and transparent.

333. See for example Gas Act 1986, s 26; Electricity Act 1989, s 14; Water Act 1989, s 18; Telecommunications Act 1984, s 15; Railways Act 1993, s 15. The role of the MMC in relation to the privatised utilities is succinctly summarised in the MMC statements "Utility References" and "Licence Modification References", which can be found on the internet at web site http://www.open.gov.uk/mmc/util.htm. The Court of Appeal was recently prepared to enforce the electricity regulator's compliance with MMC recommendations in the case of R v Director General of Electricity Supply ex parte Scottish Power plc (unreported, Court of Appeal, Staughton LJ, Morrit LJ, Sir Ralph Gibson, 3 February 1997). In that case the Court of Appeal held, allowing an appeal from the decision at first instance declining the applicant's judicial review application, that the Director General's calculation of supply price controls in respect of Scottish Power plc was not rationally based. Noting that "the MMC Report on this matter could not have been more clearly drafted" (see p 13 of the unreported judgment) the Court of Appeal allowed the appeal, quashed the decision at first instance and referred the matter back to the Director General to reconsider the modification of the appellant's licence. (I am grateful to Mr Colin Scott of the LSE Law Department for forwarding a copy of this unreported judgment to me.) For a discussion of this case see McKnight, "Current Survey - R v The Director General of Electricity Supply ex parte Scottish Power Plc" (1997) 8 Util LR 126. At the time of writing judicial review proceedings are pending against Douglas McIldoon, the Northern Ireland electricity regulator, after he refused to follow MMC recommendations relating to the pricing structure of Northern Ireland Electricity. See article in The Times, 7 August 1997: "Ulster regulator ignores MMC pricing proposals" and in The Times, 16 August 1997: "NIE seeks review over price-setting." For some further discussion of these developments see Graham, "Judicial Review and the Regulators" (1997) 8 Util LR 107.

334. See Lipworth, supra note 325, p 104: "Above all, I believe very strongly in a system that is open - and one in which analysis and adjudication are performed by independent individuals, free from any governmental or other pressures. This is most important in large contested mergers where the parties' emotions can run high. In my view these principles hold good today. The MMC has shown over the years that it is able to accommodate all its diverse work and roles without compromising the basic tenets of a fair, thorough, and independent investigation."
The MMC procedure has also been seen as imposing a form of regulatory sanction on regulated interests by acting as an incentive to agree on proposed licence amendments without the need for the expense and delay involved in an MMC reference.\(^{335}\) The current OFTEL proposal to invest the Director General of Telecommunications with wide ranging discretionary powers to proscribe anti-competitive practices on the part of licensees such as BT provides a case in point.\(^{336}\) While a company such as BT may be in a better position, in terms of overall resources, to pursue an MMC appeal than a regulatory body such as OFTEL, it nevertheless faces the possibility of an adverse (and uncertain) outcome which renders forward corporate planning in strategic areas a difficult undertaking.

Those who are more sceptical of the need for an appeal on the merits point to the fact that the regulator is the body or person invested by Parliament with the task of regulating and should be left "to get on with the job", with the sanction of judicial review hovering in the background providing a sufficient means of correcting any procedural or other unfairness which may be present in the decision making process.\(^{337}\) The adherents of this view argue that there is no guarantee that the MMC can reach a better decision on the facts than a regulator acting at first instance and that MMC procedures are by their very nature, cumbersome, expensive and time consuming, serving only to add another layer of bureaucracy to the regulatory process. Other critics have focused on the structure of a possible appeal mechanism in itself, arguing that the

\(^{335}\) Dieter Helm, for example, points to the incentive role exercised by the MMC in the following terms: "It is clear that the MMC has played two distinct roles in relation to regulation: it has acted as a powerful threat to ensure that licence amendments are accepted which extend the scope of regulation (for example, accounting separation in BT and, most extraordinarily, plant disposal and pool price capping in electricity generation), and it has played a role in constraining outcomes in periodic reviews. In many respects, its role has therefore extended far beyond the actual cases brought before it." (See Helm, "Regulating in the Public Interest" in Helm (ed), supra note 325, pp 160-161.)

\(^{336}\) The dealings between BT and OFTEL on this proposed licence condition will be dealt with in more detail in the case study discussed in chapter 9.

\(^{337}\) Such a view was expressed by Professor Kay of the London Business School at the OFTEL public hearing at King's College London, attended by the writer, on 23 November 1995.
MMC is not appropriately structured to act as a general appeal body in relation to regulatory decisions.\textsuperscript{338}

This writer is prepared, though not without some reservation, to concede a role for a body hearing an appeal on the merits against regulatory decisions, especially where such a body has the power to give reasoned consideration to questions of policy in a particular sector, such as energy, transport or communications. Such a right of appeal would serve to control the large measure of discretion vested in individual regulators while promoting consistency of policy in particular sectors of the economy. This in turn would meet another of the criticisms of UK regulation, that it is \textit{ad hoc} in nature and does not adequately serve to co-ordinate the activities of particular sectors.\textsuperscript{339}

Part of the difficulty in using the MMC as the general appeal body is that this procedure attracts the criticism that it may amount to making use of a sledgehammer to crack a walnut. Not all regulatory appeals on the merits are sufficiently complex to justify the full MMC treatment. Indeed it may be possible to define the issues arising on some regulatory appeals in quite narrow terms. This criticism can of course be overstated. The MMC has power to regulate its own procedure\textsuperscript{340} and is also subject to general directions given to it by the Secretary of State.\textsuperscript{341} These powers ought to be sufficient to enable the MMC to develop sufficiently flexible procedures for the hearing of appeals involving less complex regulatory issues, although in practice such a level of procedural flexibility has not been particularly evident to date.

Some alternative structures are possible. The 1989 White Paper on Restrictive Trade Practices, for example, recommended the establishment of a Restrictive and Regulatory

\textsuperscript{338} Lever, for example, points to the fact that the total membership of the MMC is too large and the proportion of members involved in any particular reference is too small to ensure coherence and consistency of decision making. See Lever, \textit{supra} note 306 at 61-63. The MMC issues reports on a wide range of references, as can be seen from its publication lists for 1995 and 1996. The MMC reports for these two years are available on the internet at the MMC web site pages http://www.open.gov.uk/mmc/rep1995.htm (for 1995) and http://www.open.gov.uk/mmc/rep1996.htm (for 1996).

\textsuperscript{339} For a discussion of the problem of achieving consistency of policy on a sectoral basis in the context of UK economic regulation see Helm, \textit{supra} note 325, pp 159-160.

\textsuperscript{340} See Fair Trading Act 1973, s 81(2).

\textsuperscript{341} \textit{Ibid}, s 81(2).
Practices Tribunal, a suggestion which has been echoed more recently in the draft 1996 Competition Bill.\textsuperscript{342} It was proposed that membership of this tribunal would be drawn from the MMC, with some MMC members being appointed specifically to sit on the new tribunal. Around ten persons would be appointed for the purpose and would sit in panels of three.\textsuperscript{343} Members of the tribunal would be drawn from persons with a background in business, economics and the professions, with each panel to include a legally qualified member.\textsuperscript{344} Such a structure would allow additional flexibility for regulatory appeals but so far there seems to be little sign of these proposals proceeding further.

The issue of delay is also problematic. In a judicial review proceeding an application for review and subsequent appeals can be heard on an urgent basis if the importance of the matter warrants this course. Judicial review applications and subsequent appeals in the broadcasting and rail industries have been heard quite quickly, as will be discussed in chapter 8. On the other hand the MMC procedure is a comparatively leisurely one, with time estimates for completion ranging from 6 to 12 months. The regulators are obliged to factor delay periods of this magnitude into the regulatory process where licence amendments are in issue.\textsuperscript{345} In the case of references to the MMC in its role as a competition law body the slowness of the procedure has also given rise to critical comment from time to time, most recently in the context of anti-competitive practices in relation to local bus transport.\textsuperscript{346}

Finally, and perhaps more significantly, the MMC procedure, which embodies public interest considerations, does not allow for the possibility of the parties reaching a

\begin{itemize}
\item \textsuperscript{343} \textit{Ibid}, para 4.7.
\item \textsuperscript{344} \textit{Ibid}, para 4.8.
\item \textsuperscript{345} Information supplied to the writer by Mr John Bean, Head of Interconnection Policy at OFTEL, during an interview on 21 November 1995.
\item \textsuperscript{346} See \textit{Transport Committee First Report on the Consequences of Bus Deregulation}, supra note 149, Volume 1, paragraph 63: "Several witnesses drew our attention to the slowness of both the OFT's and MMC's procedures....The Chartered Institute of Transport described the investigation procedures as 'cumbersome', a verdict with which the MMC itself agreed."
\end{itemize}
negotiated solution in the course of the inquiry and so resolving a regulatory dispute by a consensual process. Once the process begins, it moves inexorably towards completion and the Regulator is ultimately obliged to have regard to the MMC's recommendations when implementing the required licence amendments. While such a process promotes openness and reduces the possibility of private deals influencing regulatory outcomes, there may well be some scope for greater use of consensual procedures. Such a development need not be synonymous with secrecy and concealment, as the discussion of possible consensual procedures in chapter 11 will endeavour to show.

One encouraging sign, however, is that the courts, at least in relation to the takeovers and mergers role of the MMC, have been prepared to adopt a position of relative judicial deference to the Commission's expertise in this particular area.347 Such judicial attitudes indicate that in the ordinary course of events the courts will defer to the decisions of specialist tribunals such as the MMC. If some form of appeal on the merits is to be preserved, (which on balance this writer personally favours, at least until such time as improved competition law structures are put in place in Britain), then a body such as the MMC, suitably constituted for the circumstances of a particular regulatory appeal, ought to prove as suitable for this purpose as any alternative which has so far been suggested.

7.10 The EC Influence on UK Economic Regulation

7.10.1 The Influence of Continental Systems

In approaching the subject of the influence of EC law on economic regulation in Britain, some consideration of the differing characteristics of European legal systems is useful by way of general background. In France, for example, the relationship between the Executive and the Legislature is constitutionally more complex than is the case in the UK. The French state has traditionally always exhibited a degree of

dirigisme (or interventionism) in relation to business and industry in general, and delegated legislation in the form of state decrees has enjoyed a firm constitutional basis. A detailed discussion of the French constitutional position in this area is beyond the scope of this work and is in any event a task which others more qualified in this area have undertaken in some detail. However some brief analysis is appropriate here.

Under the French constitution the legislature in France is not sovereign in the British sense. Article 34 of the French Constitution sets out various subjects on which the legislation may enact laws (lois). (Interestingly these subjects include nationalisation and privatisation). Matters not covered by Article 34 are of un caractère réglementaire and may be the subject of decrees (décrets) by the Executive under Article 37, which can be issued without legislative approval. These decrees can be reviewed by the Conseil d'État, the system of higher administrative courts dealing with matters of public law. Judicial review is available in France in relation to a range of public law issues, including valuation aspects of the privatisation process. While it is difficult to make comparisons with the United Kingdom position given the greater role of the state in French public affairs and the lesser emphasis on the separation of powers in government, the French constitutional position does exhibit a comparatively high degree of acceptance of the role of delegated legislation in public administration.

348. See, for example, Brown and Bell, French Administrative Law (Clarendon Press, Oxford, 4th ed, 1993); Graham and Prosser, Privatizing Public Enterprises: Constitutions, the State, and Regulation in Comparative Perspective (Clarendon Press, Oxford, 1991), chapter 2; Suleiman, "The Politics of Privatization in Britain and France" in Suleiman and Waterbury (eds), The Political Economy of Public Sector Reform and Privatization (Westview Press, Boulder, Colorado, 1990), chapter 5. The current French government of Prime Minister Lionel Jospin could not be accused of being enthusiastic supporters of the concept of privatisation of state enterprises, although EU imperatives have necessitated some activity in this area. For an illuminating discussion of these issues see article in The Times, 22 September 1997: "The privatisation that dare not speak its name".

349. "Les nationalisations d'enterprises."


351. For a more detailed discussion of these particular provisions see Graham and Prosser, supra note 348, pp 43-44; Prosser, "Constitutions and Political Economy: The Privatisation of Public Enterprise in France and Great Britain" (1990) 3 Mod LR 304 at 306-307.

352. See Graham and Prosser, supra note 348 at pp 57-59; Prosser ibid, pp 313-314.
In Germany the constitutional position relating to the acceptability of administrative rules or decrees is equally as complex as in France (and just as challenging for an outside observer to comprehend) but in some areas of industry regulation progress has been made towards implementing a regime involving administrative rule making. Such developments are evident, for example, in the telecommunications sector where the Federal Ministry for Post and Telecommunications, which also acts as the industry regulator, conducts regular public hearings which provide the basis for regulatory rules for the industry.353

When considering the application of EC rules, which have to take effect across a range of jurisdictions within the European community, some appreciation of the functioning of continental systems, such as those in force in France and Germany, is useful. The differing approaches taken in areas such as the separation of powers shed considerable light on divergences in the administrative process between Britain and continental jurisdictions. A recent study of this area by Allison has highlighted the influence of some of these differences.354 It is instructive to bear these matters in mind as we move on to consider the detailed effect of EC law on UK economic regulation.

353. For an interesting discussion of the German regulatory regime in the telecommunications industry see Preissl, “Telecommunications in the Federal Republic of German. The Design of Regulatory Institutions” (1994) 4 Util LR 188.

354. See Allison, A Continental Distinction in the Common Law: A Historical and Comparative Perspective on English Public Law (Clarendon Press, Oxford, 1996), p 189: "In France, the historic development of the French separation of powers ensured that the Conseil d'Etat answered the need for both judicial independence and administrative expertise. The Conseil d'Etat could therefore develop a dynamic public law which gradually silenced liberal criticism. Its success in extending the liability of the state and fulfilling an extensive judicial role entrenched the institutional and substantive French distinctions between public and private law. // The English separation of powers has had a contrasting effect. It has not justified dynamic judicial intervention in the administrative process by ensuring independent and expert judges. Rather, it has left a legacy of judicial restraint, uncertainty engendered by the doctrine of ultra vires, and general unease about justiciability." For further discussion in this area see Barendt, "Separation of Powers and Constitutional Government" [1995] PL 599.
7.10.2 Primary, Secondary and Tertiary Rules in the EC Context

In the EC context, rule types can be given the same classification of primary, secondary and tertiary as is the case with rules in force in the United Kingdom, as Baldwin has pointed out in his recent study of the characteristics of EC rule making.\(^{355}\) Primary rules include the treaties and source documents constituting the European Union, and defining its powers.\(^{356}\) Secondary rules, the validity of which arises out of the various EC treaties, can be divided into three basic categories, regulations, directives and decisions.\(^{357}\) Under Article 189 of the EC Treaty regulations are of general application, are automatically binding on member states and are directly enforceable in courts at either the national or Community level. They depend for their validity on the Treaty provisions from which they are derived.

Directives, by contrast, are enforceable in the manner chosen by an individual member state. Enforcement action must be consistent with the attainment of the objective of the directive in question.\(^{358}\) Again directives depend for the validity on defined Treaty provisions. If a member state does not implement a directive within the period prescribed then such a directive may be enforced directly by an individual against a member state (or an emanation of the state) but not between private parties themselves. A right to damages may arise where individual rights are at issue.\(^{359}\)

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357. For a general discussion of the characteristics of EC secondary rules see Baldwin, *supra* note 12, pp 220-226.

358. As Article 189 of the EC Treaty puts it: "A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods."

359. This principle is derived from the well known recent case of *Francovich v Italian State* [1992] IRLR 84. As Baldwin, *supra* note 12, puts it at pp 224-225: "The implications of State liability may, nevertheless, be considerable. The Francovich ruling indicates that where an individual suffers damage through a Member State's failure to implement Community obligations, then an action in damages may avail against the State if the objective sought by the Directive involves
The discretion given to individual member states as to the mode of adoption of EC directives is in effect an example of self-regulatory action in the EC context, as has been pointed out by at least one commentator in this area.360 Finally in relation to secondary rules, decisions of the European Council or the European Commission are directly binding on member states, individuals or corporate bodies and do not allow for the exercise of any discretion in this process, unlike the position with directives.

A variety of tertiary rules have also been made by the various EC organs, as Baldwin has pointed out.361 These include resolutions and declarations of EC institutions, declarations and statements of policy, Council deliberations and other determinations of EC bodies.

Much EC rule making in the economic area is directed at harmonising economic activity within the EC and furthering the attainment of a Single European market. Directives are the most commonly used form of secondary rule making and allow for individual responses on the part of member states engaged in their implementation. Baldwin has traced the evolution of EC thought in this area from a traditional view of strict harmonisation towards a new approach based on the preparation of technical specifications giving effect to the essential thrust of a Directive.362

The issue of the domestic enforceability of EC Directives and legislation has been a complex and controversial area. From a regulatory perspective there have been periodic calls for the development of European-wide regulatory agencies to provide

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361. For a description of the variety of EC tertiary rules see Baldwin, supra note 12, pp 226-230.

362. See the discussion in Baldwin, supra note 12, pp 233-241.
essential co-ordination and administrative assistance to member states, although the
jurisdictional basis for such initiatives remains uncertain. Some member states,
particularly Germany, have expressed support for the concept of a centralised
European competition authority to be responsible for the enforcement of EC
competition law. Commentators such as Baldwin have also raised queries as to
the legitimacy of EC rule making when assessed against standardised criteria in this
area.

At the practical level some illustrations of the application of Directives in areas of
relevance to economic regulation may usefully be given here. The first example to
be examined is the well known case of Foster v British Gas. This 1991 decision
of the House of Lords concerned the application of Article 5(1) of EEC Council
Directive 76/207 which guaranteed the same working conditions for men and
women without discrimination on the grounds of sex. The case was brought by
former female employees of the nationalised entity, British Gas Corporation, (whose
liabilities were subsequently acquired by the privatised entity, British Gas plc, which
in turn, as noted in part 7.4.3(ii) above, has demerged into two separate entities as of
February 1997).

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363. See for example Baldwin, supra note 12, p 267: "In the opinion of some commentators the time
has come to extend the use of specialized regulatory agencies within Europe. Such bodies might
prove useful in a number of respects by providing expertise in preparing, executing, evaluating,
and co-ordinating Community policies; linking national administrations; informing decision-
makers; supporting Member States with scarce administrative resources; monitoring
implementation; organizing exchanges of experience; and helping to develop innovative
responses. Agency structures might, moreover, offer greater stability and more systematic action
than is possible when relying on Commission action and might, additionally, encourage public
discourse on regulatory matters. Objections to the use of such agencies might, however, be
made. Member States would be likely to resist with vigour the delegation to autonomous
agencies of broad law-making and enforcement powers - the intrusion on Member States
competence would be highly provocative. Nothing in the EC treaties, moreover, provides for
such structures."

364. See, for example, McGowan and Wilks, "Disarming the Commission: The Debate over a
European Cartel Office" (1995) 33 JCMS 259; McGowan and Wilks, "The first
Res 141 at 162-164.

365. See the discussion in Baldwin, supra note 12, pp 271-287, who assesses the theoretical validity
of European rules by reference to their legislative mandate, issues of accountability and control,
due process, expertise and efficiency and finally effectiveness.
The female employees in question had been the subject of compulsory retirement at the age of 60 although male employees of the Corporation were not required to retire until the age of 65. The House of Lords had referred a preliminary question to the European Court of Justice concerning whether British Gas Corporation was a body which was subject to the equal treatment directive. The European Court had held that bodies which were responsible for providing state controlled public services were so bound. Accordingly the House of Lords, applying this ruling in the light of the relevant provisions of the legislation establishing the British Gas Corporation, reached the conclusion that British Gas Corporation was indeed subject to the Directive. Accordingly the appeal was allowed and the House of Lords directed that the proceedings be restored before the Industrial Tribunal to assess the level of compensation to which the appellants were entitled.

Similar arguments as to the enforceability of directives against privatised entities (implementing an earlier EC Directive on transfers of employment) have arisen in relation to the enforcement of the TUPE regulations against the regional water companies, as was noted in chapter 4. In the environmental area, similar considerations have arisen in relation to the implementation of a 1990 EC Directive relating to freedom of access to environmental information.

In the latter case, British Gas plc was the owner of approximately 1150 former gas production sites in the United Kingdom. A study conducted by the environmental lobby group, Friends of the Earth, during 1994 revealed that at least 68 such sites in


367. The relevant part of the ECJ's ruling on this issue can be found at p 709 of the All ER report of the decision in Foster. "It follows from the foregoing that a body, whatever its legal form, which has been made responsible, pursuant to a measure adopted by the state, for providing a public service under the control of the state and which has for that purpose special powers beyond those which result form the normal rules applicable in relation between individuals is included in any event among the bodies against which the provisions of a directive capable of having direct effect may be relied on..."


the Greater London area were potentially contaminated,\textsuperscript{370} in some cases possibly by carcinogenic chemical residues of various kinds. Some of the sites were in close proximity to parks, primary schools and housing estates.\textsuperscript{371} These revelations led to further controversy when British Gas refused to provide further information on investigative work which it was undertaking in relation to the issue,\textsuperscript{372} while publicly maintaining that its decontamination programme was entirely adequate.\textsuperscript{373}

In this case, enforcement of the 1990 EC Directive against British Gas would again have involved demonstrating that the company (despite its privatised ownership structure) was a public body with responsibilities for the environment. The precedent in the Foster decision would no doubt have gone some distance toward supporting such an argument,\textsuperscript{374} even though the Foster case concerned the nationalised version of British Gas.\textsuperscript{375} However, such examples illustrate that enforcement of EC Directives in the regulatory area may be by no means a straightforward task.

7.10.3 EC Regulatory Initiatives

The EC Treaties and EC legislation have exerted their own influence on the shape of economic regulation in the member states. For example, reference has been made

\begin{itemize}
\item[371.] See article in \textit{Time Out} magazine, February 1-8 1995, "Government accused in polluted land scandal".
\item[372.] See article in \textit{The Independent}, 19 March 1995: "British Gas in secrecy row over poisoned sites".
\item[373.] See letter from Cedric Brown, then Chief Executive of British Gas, to the editor of \textit{The Independent}, 27 March 1995: "British Gas does ensure that sites are made safe".
\item[374.] I am grateful to Adam Garfunkel and Liana Stupples of Friends of the Earth for providing relevant information in this area to me by way of a letter dated 27 April 1995 and subsequent discussions. Further useful information on the implementation of the 1990 EC Directive can be found in the discussion paper, \textit{Proceedings of a European Conference on 'Delivering the Right to Know': The implications of the Directive on the freedom of access to information on the environment (90/313/EEC')} (Friends of the Earth, London, 2 April 1993).
\item[375.] The cases concerning the privatised water companies and the TUPE regulations, referred to in note 72 to chapter 4, provide more direct support for such an argument. For further discussion on this topic see de Smith, Woolf & Jowell, \textit{supra} note 356, p 832.
\end{itemize}
earlier in this chapter to the effect of the "Third Package" of EC legislation in liberalising the market for air passenger transport between European destinations.\textsuperscript{376}

Those industries which directly impinge on trade between the member states may accordingly become subject to the competition provisions in Articles 85 and 86 of the Treaty of Rome. As has been noted earlier in this chapter, this is a considerably more stringent regulatory regime than that applicable under UK domestic law. In the case of industries such as railways, these generally have limited direct effect on trade between the member states, although the opening of the Channel Tunnel in late 1994 has arguably raised the issue of the applicability of the EC competition provisions to the franchised service operators using the Tunnel.\textsuperscript{377}

However, rail regulation is not totally exempt from EC influences. A 1991 EC Directive dealt with the development of railways within the EC.\textsuperscript{378} This Directive, which took effect on 1 January 1993, is aimed at adapting Community railway infrastructure to the needs of the single market. The Directive provided for separation between the management of operations and infrastructure from transport services in the railway industry, improved access to rail networks of member states and management of rail operations on a more independent basis.\textsuperscript{379} Further supplementary provisions along similar lines have been proposed by the European Commission.\textsuperscript{380}

In the electricity industry the European Commission has been concerned with adopting measures aimed at facilitating a single European market in energy. Draft

\textsuperscript{376} See the discussion in part 7.6.2(ii) of this chapter.


\textsuperscript{379} For a summary of these EC initiatives see Maltby, "Competition Law Implications of the UK Railways Act 1993" [1994] 4 ECLR 239 at 241.

\textsuperscript{380} See the proposed Directives set out at OJ 1994 C24/2 and OJ 1994 C24/6.
proposals were published early in 1992 and were revised and reissued in late 1993.\textsuperscript{381} The latest proposals provide for open competition among member states in relation to electricity generation, together with competition in electricity supply either based on negotiated access for third parties or on the agency of a Single Buyer engaged to purchase electricity for defined customers. The proposals also require member states to provide effective industry regulation on a national basis.\textsuperscript{382} Many aspects of the proposed regime are extremely controversial at the political level among the member states and as at early 1997 it seems doubtful whether workable proposals for reform can be agreed within a reasonable time frame.

The interface between EC competition law and deregulated industry structures among the member states is also an area of some difficulty. If for example, a utility company which has just been privatised is of substantial size and has a dominant industry position, the question arises as to whether such a company should be placed in the position of being potentially in breach of Article 86 merely by reason of legislation passed by a member state dictating the form of its corporate structure.

While Article 90(2) of the Treaty of Rome provides a possible defence for such an entity, the scope of this provision is a matter of some uncertainty.\textsuperscript{383} Deregulated public utilities in a dominant position may conceivably fall within the exemption in Article 90(2). However difficult issues of EC competition law arise in this context.

\textsuperscript{381} For a description of the Commission's most recent proposals relating to the structure of a single European electricity market see Hancher, "Towards a Unified European Electricity Market: The Commission's Latest Proposals" (1996) 7 Util LR 35. See also Slot, "Energy and Competition" (1994) 31 CMLR 511. A more detailed survey of the legislative background to the single European energy market can be found in McEldowney, \textit{supra} note 85, chapter 2 entitled "The European Dimension". Developments in the EC electricity market and in relation to EC public utilities generally are described in Hancher, "The impact of community law on public utility law" (1990) 1 Util LR 32.

\textsuperscript{382} Article 21 of the latest draft proposal requires member states to create "appropriate and efficient mechanisms for regulation, control and transparency" and also requires them to avoid any abuse of a dominant position in the industry. Given the present disparity in competition law structures between the UK and other EC jurisdictions consistency in the regulatory regimes to be adopted by the individual member states may prove to be a difficult goal to achieve in practice.

\textsuperscript{383} Article 90(2) provides: "Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community."
and some commentators have suggested that it is possible that in future the European Court will cut back the scope of the available exemption.\textsuperscript{384}

Despite these uncertainties, Article 90(2) has proved to be a powerful tool in the hands of the Commission and the ECJ and has been applied in a variety of circumstances. The ECJ considered its scope in a 1985 decision in which it held that British Telecom's refusal to allow private messenger services to forward messages involving overseas parties was an abuse of BT's dominant position. In that case Article 90(2) did not apply as BT was pursuing its own commercial interests in relation to the matter.\textsuperscript{385} In the case of Belgian Postal Services, a public monopoly, the ECJ held that continuation of its activities was justifiable in the public interest but the monopoly should not be extended so as to completely exclude all forms of competition, for example from courier or rapid delivery services.\textsuperscript{386}

Finally, in areas such as financial services regulation, the move towards a single market has also been evident. EC directives have been issued with the intention of harmonising European regulatory initiatives in this area.\textsuperscript{387} However the intimate

\begin{itemize}
  \item[384.] See for example Smith, "Deregulation of Public Utilities: The Scope of the Exemption in Article 90(2) of the EC Treaty" (1996) 7 Util LR 111 at 115: "Although the scope of the exemption in Article 90(2) has been extended by recent ECJ jurisprudence, it is clear that it does not completely meet the needs of deregulated undertakings. It is possible to identify three major problems with its application: firstly, the exact scope of the provision is uncertain. It is unclear whether such a deregulated undertaking could be deemed to be 'entrusted' with rights by the State merely by the act of privatisation: the Act of Parliament actually signifies the withdrawal of any rights the undertaking previously had. Likewise, although a public utility should have no great difficulty establishing that it is an undertaking operating service, the question remains whether it can still rely on the exemption if it operates at a different level of the market than that envisaged by the privatising Act."
  \item[385.] See \textit{Italy v Commission} [1985] ECR 873.
  \item[387] See for example EC, \textit{directive on investment services in the securities field}, 93/22/EC; EC, \textit{directive on capital adequacy requirements for investment firms and credit institutions}, 93/6/EC, both of which were due to be implemented by member states by 1 January 1996. The former directive is intended to allow investment firms the right to become established in any member state. Such a regime was already effectively in force in the UK in terms of s 31 of the 1986 Act, which creates the concept of a "Europerson", an authorised provider of investment services in the UK operating under a harmonised regime in another member state. For a discussion of progress in this area see Lee, "The Legal Foundation for Competition in EC Capital Markets: The Gap Between Rhetoric and Reality" (1994) 14 Int Rev L & Econ 163.
\end{itemize}
correlation between investor confidence and regulatory regimes was affirmed by the European Court in a recent 1995 decision in which the Court, upholding the Netherlands financial services regulatory regime (part of which restricted "cold calling" of customers, allegedly in violation of the freedom to provide services under Article 59 of the EC Treaty), held that the objects of the particular national regulatory regime (maintaining investor confidence and the reputation of the Netherlands financial services industry), justified the restrictions imposed in that case.\textsuperscript{388} Although some member states have had difficulty meeting the January 1996 implementation deadline it seems that reasonable progress is being made towards a harmonised system of EC regulation in this area.

7.10.4 Telecommunications within the EC - An Industry Case Study

During the 1980s and into the 1990s the European Commission began to take a more active approach to EC telecommunications issues.\textsuperscript{389} The form of EC telecommunications regulation was set in a 1987 Green Paper, which provided a framework for liberalisation of access to telecommunications markets within the EC.\textsuperscript{390} The thrust of this approach was the harmonisation and liberalisation of EC entry requirements so as to promote an increase in operator numbers and to encourage competition in EC telecommunications markets. The competitive process itself would be subject to existing EC competition law with its protections against abuses of the competitive process.

\textsuperscript{388} See Alpine Investments BV \textit{v} Minister van Financien [1995] All ER (EC) 543.

\textsuperscript{389} For a discussion of the evolving role of the Commission in the EC telecommunications area see Flynn, "Telecommunications and EU Integration" in Shaw and More, \textit{ibid}, p 217. Reference to the current status of EC telecommunications policy can be found on a useful internet web site referring to various EC resolutions and directives in this area. See http://www.ispo.cec.be/infosoc/legreg/telecom.html.

In adopting this policy, the Commission was in part attempting to counter the effect of strong national monopolies existing in the industry.\textsuperscript{391} The implementation of telecommunications reform by the Commission has proved to be controversial during the 1990s, with several of the member states challenging the validity of the Commission's Directives on equipment and services.\textsuperscript{392} The most recent initiatives in this area have been directed towards liberalisation in the basic voice telephony market following a Council Resolution in 1993.\textsuperscript{393} This Resolution called for full liberalisation among the member states by 1998. A draft Directive calling for full liberalisation of the EC telecommunications market by 1 January 1998 was issued for public consultation by the Commission on 10 October 1995,\textsuperscript{394} and was adopted in its final form by the Commission on 13 March 1996.\textsuperscript{395}

The European Court of Justice has issued several significant rulings in this area, particularly in relation to the operation of the Equipment Directive of 1988,\textsuperscript{396} which implemented measures in the 1987 Green Paper dealing with liberalisation of the


\textsuperscript{393} See Council Resolution, 22 July 1993 on the review of the situation in the telecommunications sector and the need for further development in that market (OJ 1993 C213/1).


\textsuperscript{395} For a discussion of these events see Sauter, "Taking the Parallel Tracks of European Telecommunications Regulation into the Future" (1995) 6 Util LR 142. See also Haag, "Developments in EU Telecommunications Policy in 1995" (1996) 7 Util LR 116 at 119: "The Directive gives legal force to the political agreement to open the European telecommunications sector in full by 1 January 1998. In addition to the mere obligation for the Member States to annul special and exclusive rights, the Directive specifies some minimum requirements derived from the EC competition law that the national regulatory regimes must comply with in order to allow effective market access. // The Directive sets out minimum regulatory requirements, in particular for the licensing of telecommunications services and networks, the financing of universal service, the provision of numbers and granting of rights of way as well as the regulation of interconnection with voice telephony services and the public switched networks of the telecommunications organisations."

\textsuperscript{396} Dir. 88/301/EEC - \textit{Competition in the market for telecommunications terminal equipment}, (OJ 1990 L192/10).
equipment market in telecommunications. The Belgian regulatory regime was examined in a 1993 decision, in which the Court upheld the role of the Belgian regulatory authority in prohibiting sale or hire of equipment not previously approved by it, on the basis that this regulatory jurisdiction did not infringe the relevant Treaty Articles. However in two other cases decided at the same time, the ECJ disallowed French regulatory rules concerning prior approval of equipment where the approving body (being part of the same Ministry responsible for both regulatory and operational matters) was not sufficiently independent.

The Equipment Directive has received a luke-warm reception in several of the member states and has faced some domestic opposition in the form of restrictions on the source of first telephone purchases and in a reluctance to adopt the Common Technical Regulations (CTRs) prescribed by more recent Council Directives. As Flynn has noted, progress in liberalising the equipment area has been somewhat excruciatingly slow. The area of service provision has been no less problematic from an EC perspective. Some member states have expressed a preference for light-handed regulation, particularly in relation to issues of market access and interconnection. It is perhaps no coincidence that such an approach has been advocated by member states with dominant national telecommunications operators.

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400. See Flynn, supra note 389, p 231: "All in all, the member states' approach to the telecommunications equipment sector has been less than fully co-operative. While an integrated, competitive market for telecommunications equipment is emerging, this is occurring more slowly than the (relatively) well established body of secondary legislation in this field might indicate."

401. The German Government, for example, initially showed little enthusiasm for allowing foreign competitors access to a market which was largely dominated by the state owned entity Deutsche Bundespost Telekom (DBP Telekom). See for example Preissl, supra note 353 at 194: "Barriers to entry are evident, for example, in exaggerated tests for the approval of
New Zealand experience shows that informal arrangements in this area which depend on the goodwill of the participants for their successful implementation, and are accompanied by minimal regulatory sanctions on the part of the state, offer little cause for optimism. Some advocates of a free market approach in this area seem to presume that a kind of inherent respect for market processes will automatically engender co-operation on the part of dominant operators in the area of interconnection. Such assumptions show a remarkable naivety and a distinct lack of appreciation of the commercial realities of the market place. The thought that a dominant operator, long cosseted against the icy blasts of competition, will eagerly welcome competitors who will have the direct effect of eroding its substantial monopoly profits only needs to be expressed to illustrate its essential lack of realism.

The EC approach to network provision of leased lines has been comparatively light-handed in nature. The relevant Council Directive was adopted in June 1992 and came into effect a year later in June 1993. This Directive is an important EC regulatory measure and is aimed at ensuring the availability of leased lines and the removal of interconnection restrictions. It contains an interesting conciliation procedure in Article 12 which is available to users who claim to be injured by infringement of the Directive.

equipment. In addition, access to the network for providers of value-added services seems to meet excessive bureaucratic obstacles. Some of these difficulties are not due to a lack of compliance with EC rules. In part, they are an expression of rather more subtle ways of keeping markets clear of foreign competitors and of attempts to stick to national technology and competition policies. Partly, however, they are an indicator of an early stage of deregulation, where many changes have not yet been effected, and new procedures still have to be 'learnt' by the respective institutions."


403. See for example Article 6.1, ibid: "Without prejudice to Articles 2 and 3 of Directive 90/388/EEC, Member States shall ensure that when access to and usage of leased lines is restricted, these restrictions are aimed only at ensuring compliance with the essential requirements, compatible with Community law, and are imposed by the national regulatory authorities through regulatory means. // No technical restrictions shall be introduced or maintained for the intercommunication of leased lines and public telecommunications networks."
This procedure is a two stage one. There is first a remedy at the national level. If this does not result in agreement being reached then reference can be made to the national regulatory authority and the European Commission. If either of these bodies consider the matter should be examined further the notification can be referred to the Chairman of the ONP Committee. If the Committee resolves to take the matter up then a working group is convened which can receive submissions from the aggrieved party, the national regulatory authority and the telecommunications operator involved. However the Committee has no power to impose a binding resolution to the dispute on the parties.

The second stage procedure was implemented in June 1994 in the context of the Spanish telecommunications sector. Esprit Telecom, an international value-added provider of telecommunications services, alleged that it had been unable to obtain a leased line from Telefónica, the Spanish national operator, within a reasonable time frame. It was unable to obtain satisfaction from the relevant Spanish authorities and invoked the second stage of the conciliation procedure. Esprit alleged that it had faced a year's delay in obtaining a leased line for calls from Madrid to London. The ONP Committee which was convened decided that the matter should properly proceed to the second stage of the conciliation procedure, although the validity of this decision was itself disputed by DGTel, the Spanish regulatory authority. In the event, after a day of discussion with the ONP working group appointed to deal with the matter, the leased line was provided and certain Spanish regulatory requirements were clarified in this area.

While the conciliation procedure was therefore...
successful in this particular case, it may be doubted whether such procedures provide the universal panacea for interconnection disputes in what is often a bitterly contested area.

Proposals for an ONP Directive dealing with interconnection issues were issued by the Commission on 19 July 1995. The proposed Directive seeks to promote universal service and interchangeability among competing operators. A noteworthy aspect of the proposal is that rights and obligations of service providers vary depending upon the services which such providers offer. In particular, dominant firms are subject to specific obligations. In addition the general EC competition law rules continue to apply. The Commission has recently arranged for an initial study to be prepared in relation to competition law aspects of interconnection agreements. The application of these rules is likely to become increasingly important given the pending liberalisation of the EC telecommunications market and the absence of a European-wide regulator of the industry.

In this, as in other areas, market reforms at the EC level have encountered a range of opposition from vested interests in the member states and it seems doubtful whether the goal of full liberalisation of the industry in Europe by January 1998 will be achieved. While the Commission has played a proactive role in this area, the fragility of European Union is nowhere better illustrated than in the

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21-22 November 1994), p 17 at pp 37-39. (I am grateful to Mr Colin Scott of the LSE Law Department for providing me with a copy of this paper.)


410. See Flynn, supra note 389: "The implementation of liberalizing and harmonizing measures in respect of equipment and services by the member states and their TOs is, for the most part, a painfully slow process and belies the impression of relatively rapid progress in this sector created by the pace and the extent of legislative activity." See also Stone, "The Good, the Bad and the... Progress and Problems in Implementing the Full Competition Directive" [1997] Intl Bus Lawyer 293; article by Schenker in the Wall Street Journal of 26 May 1997: "EU Says 8 Members Trail in Telecom Market Effort", reporting that a number of EU member states are lagging behind in the timetable for deregulation of the EU telecommunications market.
telecommunications sector. Unlike the situation in the United States, where there is a comparatively well developed federal regulatory structure in place, the EC regime has no comparable agency with similar powers and roles to that of the FCC. Such an institutional initiative has been recommended but has again attracted controversy, as Scott has recently pointed out. Its future seems uncertain at the present time, although the powers given to the ONP Committee of Officials, as has been discussed above, represent a move in the direction of European-wide telecommunications regulation. In summary, EC telecommunications regulation has been something of a battleground between advocates of liberalisation (including the European Commission) and dominant national operators, several of which are still publicly owned or operated within the member states. The emphasis on encouraging the development of EC networks in areas such as telecommunications should at least ensure that the issue is not going to disappear. However, the controversy which it generates does not seem likely to disappear either.

411. For a useful recent discussion of the comparative regulatory regime in the United States and the European Community in the telecommunications area see Scott, "Institutional Competition and Coordination in the Process of Telecommunications Liberalization" in McCahery, Bratton, Picciotto and Scott (eds), International Regulatory Competition and Coordination (OUP, Oxford, 1996).

412. See Scott, ibid, part 4.1.1: "The Bangemann Group recommended in 1994 the development of a Community telecommunications regulatory authority to address the difficulties of coordinating Community telecommunications policy. This new institution might emerge from an existing organisation such as the ONP Committee, which comprises representatives of national regulatory authorities...This proposal remains contentious, but it seems likely that a new regulatory institution will emerge at the EU level to monitor and coordinate the implementation of policy, particularly in relation to licensing and interconnection...The precise form of any new EU level regulatory institution and the scope of its powers and appropriate instruments remains uncertain..." (References omitted)


414. See for example Title XII of the Treaty on European Union: "To help achieve the objectives referred to in Articles 7a and 130a (social and economic cohesion) and to enable citizens of
7.10.5 EC Influences on Economic Regulation - A Summary

The foregoing illustrations show that while national regulatory regimes continue to enjoy considerable autonomy of operation, they are becoming increasingly subject to the influence of EC legislation, particularly in the form of directives governing aspects of the development of the Single European market. Furthermore, the effect of Articles 85 and 86 of the Treaty of Rome means that markets which are characterised by one or two dominant firms, or which are monopolistic in nature, will become subject to increasing scrutiny by the EC institutions, despite the ostensible neutrality of the EC Treaty in terms of ownership structure.\(^{415}\) While purporting to leave ownership structures in the member states intact, EC law is lending increasing de facto support to the maintenance of competitive markets where the market power of dominant players is subject to strict controls.\(^{416}\)

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\(^{415}\) For a succinct summary of the situation here see Weatherill, "Book Reviews" (1996) 59 Mod LR 322: "Article 222 of the EC Treaty asserts that rules governing the system of property ownership in the Member States shall not be prejudiced by the Treaty. This seems to leave intact national choices about whether to place property in public or private hands and whether to nationalise or to privatise, subject only to the fundamental prohibition against discrimination on grounds of nationality within the scope of application of the Treaty. In reality, Community law has evolved to the point that it exercises significant influence over the scope of permissible public intervention in the market, even in areas which are untouched by the law of the free movement of goods, persons, services and capital, long regarded as the heart of Community trade law. In particular, where states choose to grant special or exclusive rights to undertakings, they may not enact or maintain in force measures that fall foul of the Treaty, including Articles 85 to 94, the competition rules."

\(^{416}\) On this subject, see Prosser and Moran, "From National Uniqueness to Supra-National Constitution" in Prosser and Moran (eds), Privatisation and Regulatory Change in Europe (Open UP, Buckingham and Philadelphia, 1994) p 145 at p 149: "Nevertheless, there are a number of ways in which Community law provides substantial constraints that are likely to have a profound effect in relation to privatization and may also shape the future divide between public and private enterprises. Thus in the area of public utilities one can see the beginnings of a community model of utility enterprise emerging as the result of the process of liberalization of telecommunications, energy, transport and postal markets. The general thrust of this is clear; the Commission is seeking to open up markets through the limitation of exclusive rights for public enterprises and by requiring the separation of regulatory functions from the operation of the service."
The example of industries such as telecommunications shows that the theory and practice of economic regulation at the Community level affords considerable scope for collision with the interests of individual member states. Institutions such as the European Commission have been increasingly active in seeking to foster a liberalised and competitive market on a trans-European basis. Whatever theoretical benefits can be claimed for this approach, it seems clear that it will remain controversial at the national level, especially given the continuing existence of state owned monopolies in many areas. It is perhaps paradoxical that in Britain, where public acceptance of European union seems ambivalent at the best of times, the existence of widespread privatised ownership in the UK economy means that British industry is in fact quite well placed to take advantage of the emerging liberalised European markets.

The foregoing discussion has also highlighted difficulties with the enforcement and effectiveness of much EC regulation. The example of the telecommunications industry shows that even quite specifically drafted directives can be the subject of indifferent enforcement and reluctant compliance at the national level. Resolution of disputes arising in difficult areas such as interconnection and universal service may ultimately depend upon voluntary consensual procedures involving conciliation and discussion. Effective mechanisms for enforcing regulatory decisions on a European-wide basis are often lacking. While EC competition law supplements some of these defects, provisions such as Articles 85 and 86 are still not directly applicable to the UK domestic situation. However, initiatives such as the new fair trading condition in UK telecommunications can be viewed as an innovative regulatory response to this situation.

Despite these difficulties the influence of EC institutions in moulding the shape of economic regulation in the EC should not be underestimated, as commentators such as Scott have pointed out. While the EC has a looser and more disjointed federal

417. See Scott, supra note 386, at p 214: "Commentary on the development of EC utilities policy has been dominated by a policy-orientated view in which change is perceived simply as a response to policy concerns. This essay has sought to provide a modest corrective to this literature by suggesting that institutions matter also. It is unlikely that the Commission pursued policies of liberalization in the utilities sectors much before the 1980s, not just because this was not on the policy agenda but also because the institutional pattern did not favour it. The emphasis on liberalization in the 1980s has occurred because the institutional dynamic of the Community has simultaneously retained for the Commission a central place in policy-making and given pre-eminence to the instruments developed for the exercise of
structure than the United States, for example, it nevertheless exhibits many political and regulatory features which are reminiscent of US experience. These include friction between the central and state authorities in various areas, the strong influence exerted by the central institutions and a regulatory approach involving what one commentator has described as "group bargaining and interest-oriented politics". As in the case of US regulation, EC regulatory initiatives have generally been undertaken with considerable accompanying transparency. Draft Directives have been issued for public consultation and extensive use has been made of position papers and other participatory mechanisms of this kind. As in the US experience, this has been reflected in comparatively lengthy time frames for the adoption of directives in certain areas. This has especially been the case where proposed reforms and regulatory initiatives have been particularly controversial, as in the telecommunications area.

There are of course some fundamental differences also. Under the US system the federal government can exercise plenary legislative powers in the areas prescribed in the US Constitution. There are also standardised administrative procedures in existence at both the federal and state levels in statutory form and a well developed system of federal regulatory agencies. The relationship between EC institutions and the member states lacks this central element of coercion. In the general absence of European-wide regulatory agencies in particular industry areas much EC regulatory activity is dependent upon the willingness of individual member states to comply


\footnote{See Bulmer, "The Governance of the European Union: A New Institutionalist Approach" (1994) 13 Jnl Pub 351 at 377.}
with both the letter and the spirit of EC directives. As the discussion above has shown, such attitudes are sometimes conspicuous by their absence.\textsuperscript{420}

EC enforcement strategies are also an area of difficulty here. Efficiency of enforcement might be improved by the increasing use of litigation as an enforcement strategy by the European Commission, in much the same way as the approach adopted by the US Department of Justice towards the enforcement of the US anti-trust laws.\textsuperscript{421} Similarly, private enforcement action could be given further encouragement and more effective remedies aimed at securing compliance by member states with Community obligations might be developed.\textsuperscript{422}

Despite these obvious areas of difficulty, it is clear that the European Community, its laws and institutions, will continue to exert an important influence on the shape of UK economic regulation. Opinions will no doubt continue to differ on whether this influence is as beneficial as that of Augustus Caesar on Rome, who boasted that he found a city of bricks and left it of marble, or is more analogous to the visitations of the Goths to the same city some time later. However, for better or worse, it certainly seems to be here to stay.

\begin{footnotesize}
\begin{enumerate}
\item See the discussion in part 6.1.2 of chapter 6. Dehousse et al advocate the use of such a strategy at, \textit{ibid}, pp 68-70.
\item See Dehousse et al, \textit{ibid}, pp 70-74.
\end{enumerate}
\end{footnotesize}
8. CONSULTATION AND PARTICIPATION IN UNITED KINGDOM ECONOMIC REGULATION

8.1 Introduction

This chapter investigates the use of and the need for techniques of consultation and participation in UK economic regulation. It begins by considering the UK experience with consultation and participation procedures in relation to secondary and tertiary rules. This includes a survey of the common law approaches in the UK, including the evolving doctrine of legitimate expectation, together with an examination of some interesting legislative initiatives from the state of Victoria in Australia and from the province of Quebec in Canada. The UK experience with tertiary rules and codes of practice will also be considered.

The chapter then moves to a consideration of the desirability of adopting standardised consultation and participation procedures in the context of UK economic regulation. This analysis begins with an examination of the need for transparency and the adequate provision of information, both on the part of regulatory bodies and regulated interests. The relationship between such procedures and third party participation, and the role of judicial review in this area, will then be examined. The ways in which such procedures might be introduced in Britain are then considered, including the extent to which the common law could require the use of such procedures and the features which would need to be addressed in any enabling legislation. This analysis will include some consideration of the influence of fundamental rights jurisprudence, particularly in the light of the European Convention on Human Rights and its application in the United Kingdom.

Finally the chapter deals with some aspects of the US regulatory model, based on standardised APA procedures, including the use of consensual and arbitral procedures in regulatory decision making, and the issue of whether it would be necessary or desirable for a commission type of regulatory structure to accompany such a regime.
8.2 United Kingdom Experience with Consultation and Participation Procedures in Relation to Secondary and Tertiary Rules

8.2.1 Introduction

This part of the chapter discusses the extent to which consultation and participation procedures have been adopted in the United Kingdom to date in various areas of social and economic regulation. It also deals with the extent to which codes of practice and other forms of tertiary rules have been utilised in Britain and the reception which has been accorded to such developments. This is done with a view to ascertaining what legislative or other changes might be necessary in order to encourage the use of such innovations in UK economic regulation.

8.2.2 Consultation Requirements in relation to Secondary and Tertiary Rules

(i) The Existing Legislative Framework

In evaluating the extent to which the use of consultation and participation procedures might be encouraged in the area of UK economic regulation, some consideration of the process of formulating delegated legislation and tertiary rules is instructive. It was noted in chapter 6 that, under the US APA, detailed requirements are in place dealing with the publication of proposed agency rules in the US Federal Register, receipt of comments and submissions from interested parties and the eventual promulgation of the rules in their final form. The whole of this process has often been accompanied by intensive judicial scrutiny through the process of judicial review, and has been the subject of some recent innovations such as negotiated rule making.

In the United Kingdom, Parliamentary control over both delegated legislation and tertiary rules has been much less far-reaching in its ambit, a situation which is of significance when the possible application of US procedures falls to be considered. If anything, the situation has regressed somewhat since last century when the publication of statutory rules was governed by the Rules Publication Act 1893. Under that Act,

which applied to all statutory rules made pursuant to any Act of Parliament by every
authority authorised to make statutory rules, all such rules were published in draft form
in the London Gazette at least 40 days prior to their adoption. Copies could then be
obtained by any public body, with the possibility of representations or suggestions from
such a body being made to the rule making authority. (There were exceptions to the
notification procedure where urgency or other special reasons applied.)

Some reflection will serve to confirm that these requirements were similar in principle
(though less extensive) than those later adopted under the Administrative Procedure
Act 1946 in the United States. In particular, the entitlement to make submissions on
proposed rules was restricted to public bodies under the 1893 Act and there was no
obligation on the part of the rule making authority to take any representations into
account, or otherwise engage in any form of structured interaction with interested
parties.

Even these limited consultation requirements were significantly altered in 1946 by the
passing of the Statutory Instruments Act in that year. While the title to that Act stated
that the new legislation was intended to "...repeal the Rules Publication Act 1893, and
to make further provision as to the instruments by which statutory powers to make
orders, rules, regulations and other subordinate legislation are exercised", the
publication requirements in the 1946 Act only took effect after the rules were made and
not beforehand. The limited opportunity afforded by the earlier 1893 legislation for
public bodies to make submissions on proposed rules was therefore diluted even
further. Furthermore the courts themselves accorded limited weight to the publication
requirements when determining the validity of unpublished or incompletely published
regulations.

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2. See Rules Publication Act 1893, ss 1(4) and 4.
3. See s 2.
4. See Statutory Instruments Act 1946, s 2(1).
5. For a discussion on the terms of the 1946 Act see Baldwin, supra note 1, pp 60-66; Craig,
6. See for example R v Sheer Metal Craft Ltd [1954] 1 QB 586, where the court took the view that
incomplete publication of a statutory order did not affect its validity, the order attaining validity
The 1946 Act applies only to "statutory instruments", which are defined as documents produced in the exercise of a power conferred on Her Majesty and exercisable by order in council, or through a power conferred on a Minister of the Crown and exercisable by statutory instrument. Consequently the Act affects only delegated legislation where the law making power is contained in an Act of Parliament. Where the rule making procedure is less formal, as occurs with the use of techniques such as departmental circulars, voluntary codes, interpretative guides and rules of practice, the 1946 Act does not apply.

A wide range of less formal rule making techniques, at least some of which, under the US APA, would be subject to the applicable notice and comment requirements, are therefore not subject to any formal publication or consultation requirements under the United Kingdom legislation in the absence of specific legislative provision in individual cases. Whether increased Parliamentary scrutiny through an expanded laying procedure would in fact be effective in practice is of course more problematic. The idea that there would be sufficient time in the Parliamentary schedule to debate

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7. See s 1 of the 1946 Act.

8. For a useful summary of the categories of tertiary rule which fall outside the ambit of the 1946 Act see Baldwin, supra note 1, pp 80-85. As Craig has noted at supra note 5, p 273: "If we desire direct validation by Parliament the basic direction of the 1946 Act would, therefore, have to be altered. A general format would have to be devised which rendered any legislative rule formulated by a public body, whether under express delegation or not, subject to some form of parliamentary scrutiny, whether it be by the negative or affirmative procedures or by simply laying the instrument before Parliament." For a further discussion of these issues see Lanham, "Delegated Legislation and Publication" (1974) 37 Mod LR 510; Campbell, "The Publication of Delegated Legislation" [1982] PL 569; Bayne, "Administrative Law - The publication of delegated legislation" (1989) 63 ALJ 355.

9. It will be recalled that the term "rule" is widely defined in §551 of the US APA as meaning "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organisation, procedure, or practice requirements of an agency...". See the discussion in part 6.4.2(i) of chapter 6.
tertiary rules in all their great variety is probably quite utopian given current Parliamentary workloads.\textsuperscript{10}

It is also useful in this context to consider the extent to which consultation with interested parties has been recognised in the United Kingdom in relation to delegated legislation. In the absence of a statutory provision of general application the issue has largely come down to the construction of consultation provisions in individual statutes. In general, the common law traditionally did not seek to impose any consultation requirements in relation to subordinate legislation.\textsuperscript{11}

The typically limited scope of an obligation to consult with interested parties under United Kingdom statutory provisions has long been recognised. Garner, writing in 1964, listed several statutes which imposed limited consultation requirements in relation to subordinate legislation.\textsuperscript{12} One statutory provision which is of interest in the present context was that contained in s 71 of the Gas Act 1948, which imposed a consultation requirement on the Minister of Power in relation to the exercise of his statutory powers to change the regional jurisdiction of an Area Gas Board. This provision required the Minister to consult with the Gas Council and with the Area Boards which were affected.

Garner also noted that some degree of voluntary consultation was also undertaken in relation to certain kinds of subordinate legislation, particularly where special interest groups such as local authorities or professional bodies were concerned.\textsuperscript{13} In practice the degree of consultation varied widely from a minimalist approach (such as mailing draft regulations to persons on a standard list), to undertaking in-depth discussions with

\begin{enumerate}
\item[10.] For a further discussion of some of these issues see Craig, \textit{supra} note 5, pp 273-274.
\item[11.] For a general discussion of these principles see Craven, "Legislative Action by Subordinate Authorities and the Requirement of a Fair Hearing" (1988) 16 Melb ULR 569, 570-578. Craig, \textit{supra} note 5, summarises the common law position at p 256 in the following terms: "At common law there is no duty to give a hearing where the order under attack is of a legislative nature; the right to a reasoned decision does not apply where the order is of a legislative or executive character; and question marks hang over the application of the prerogative orders to legislative instruments... The absence of any common law duty to consult is matched by the lack of any such general statutory duty."
\end{enumerate}
interested parties. He lamented the narrowness of the UK requirements compared to the wider notification procedures in the US APA, noting particularly the fact that individuals were much less likely to be notified and consulted in the United Kingdom than in the United States in relation to proposed subordinate legislation.\(^\text{14}\)

One might add that some thirty years later such provisions are still long overdue. Similarly views have been expressed by other commentators. Jergesen, for example, has noted the diversity of enforcement of consultation requirements in relation to administrative actions generally and has endorsed the need for greater judicial enforcement in this area, coupled with the adoption of standardised procedures by rule making authorities.\(^\text{15}\)

It is, of course, fair to note that there has been much greater emphasis given to voluntary consultation in recent British experience, both in relation to primary and subordinate legislation. More extensive consultation, both of a formal and informal kind, frequently occurs, often in conjunction with industry and trade associations or local interest groups. In the environmental area, for example, consultation requirements are prescribed by statute in relation to various matters. For example, developers undertaking projects with environmental implications must consult with local planning authorities and statutory and non-statutory consultees.\(^\text{16}\) Similarly local

\begin{itemize}
\item \textit{Garner, ibid, p 124:} "It is suggested that not enough allowance is yet made in our administrative practice in this context for the views of the individual, that consultation should normally (instead of only sometimes) be a statutory requirement, and that whereas it would not seem necessary for the process of consultation to be judicialised, the law should define with more precision than at present what should be understood by consultation. The choice of interests to be consulted should also not be left to the absolute discretion of the government department concerned... Provisions of this kind in an Administrative Procedure Act of general application have long been overdue."
\item \textit{Jergesen, "The Legal Requirements of Consultation" [1978] Pub Law 290.} The author notes at p 315: "Where matters are complicated, as where the public is involved over a period of time, it may be necessary to issue standard operating procedures such as those contained in the Department of the Environment's circulars. Viewed constructively, the legal requirements of consultation can open administrative decisions to outside contributions at no great cost to administrative efficiency."
\item \textit{For a discussion of these requirements see Ball and Bell, \textit{Environmental Law} (Blackstone Press Ltd, London, 2nd ed 1994), pp 244-245.} The statutory consultees are specified in The Town and Country (Assessment of Environmental Effects) Regulations 1988, reg 8.
\end{itemize}
Waste Regulation Authorities are required to consult widely before issuing waste management licences.\textsuperscript{17}

There have recently been suggestions in Britain that the process of making delegated legislation should be accompanied by greater Parliamentary oversight and more structured consultation procedures. Craig has drawn attention\textsuperscript{18} to the recent observations of the Rippon Commission\textsuperscript{19} in this area. That Commission stringently criticised the inaccessibility of statutes and statutory instruments and set out detailed proposals for greater scrutiny of such measures and the compulsory referral of delegated legislation to nominated departmental select committees. It placed considerable stress on the importance of consultation in the passing of delegated legislation.\textsuperscript{20} While much progress has therefore been made, much could still be done, particularly in relation to the adoption of uniform procedures and the provision of a structure to encourage effective participation by interest groups, such as consumers.

(ii) The Common Law Approach

An examination of the traditional judicial approach to consultation requirements also reveals some degree of reticence in this area, though there are more recent indications that such attitudes may be changing. In the well known case of Bates v Lord Hailsham,\textsuperscript{21} decided in 1972, the court considered the effect of s 56 of the Solicitors Act 1957, which imposed a consultation requirement in relation to the passing of general orders affecting the remuneration of solicitors in respect of non-contentious

\begin{itemize}
\item \textsuperscript{17} See Environmental Protection Act 1990, ss 35, 36, discussed in Ball and Bell, \textit{ibid}, pp 324-325.
\item \textsuperscript{18} See Craig, \textit{supra} note 5, pp 266-269.
\item \textsuperscript{20} \textit{Ibid} p 42: "The importance of proper consultation on delegated legislation should not be underestimated. For many bodies its importance is equal to - or greater than - the importance of consultation on bills. And from the point of view of those directly affected, it is equally important to get delegated legislation right."
\item \textsuperscript{21} [1972] 1 WLR 1373.
\end{itemize}
A representative of the British Legal Association (comprised of several thousand practising solicitors) had claimed the right to be consulted on proposals to abolish scale fees in conveyancing transactions, on the basis that the Association had a direct interest in the matter. Megarry J was not prepared to accept that such an obligation existed, holding that considerations of fairness and natural justice were not inherent in the legislative process in the absence of specific provisions.

Other courts have been prepared to take a more active role in enforcing consultation requirements in cases where the statutory provisions in question have afforded them this opportunity. In a 1986 decision concerning the duty of the Secretary of State to consult local authorities before making regulations affecting housing benefits, the court was prepared to hold that the Secretary had failed to undertake sufficient consultation before issuing the regulations in question and a declaration was issued to that effect. However the court in its discretion was not prepared to quash the regulations

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22. S 56(3) of the Solicitors Act 1957 required the Lord Chancellor to forward a draft order to the Council of the Law Society for comment and to allow one month for the receipt of observations in writing on the form of the order.

23. See the observations of Megarry J at [1972] 1 WLR 1373 at 1378: "Let me accept that in this sphere of the so-called quasi-judicial the rules of natural justice run, and that in the administrative or executive field there is no general duty of fairness. Nevertheless, these considerations do not seem to me to affect the process of legislation, whether primary or delegated. Many of those affected by delegated legislation, and affected very substantially, are never consulted in the process of enacting that legislation; and yet they have no remedy. Of course, the informal consultation of representative bodies by the legislative authority is a common place; but although a few statutes have specifically provided for a general process of publishing draft delegated legislation and considering objections...I do not know of any implied right to be consulted or make objections, or any principle on which the courts may enjoin the legislative process at the suit of those who contend that insufficient time for consultation and consideration has been given."

24. See for example Lee v Department of Education and Science (1967) 66 LGR 211 (a parent, school governor and school master were entitled to make representations on changes in the government of a voluntary school on the basis that they were persons "concerned with the management or government of the school" in terms of s 17(5) of the Education Act 1944); Agricultural, Horticultural and Forestry Training Board v Aylesbury Mushrooms Ltd [1972] 1 WLR 190 (an obligation on the Minister of Labour to consult an organisation or association "appearing to him to be representative of substantial numbers of employers engaging in the activities concerned" in terms of s 1(4) of the Industrial Training Act 1964 obliged the Minister to consult the Mushroom Growers Association, representing 85% of growers/employers, and the Minister's staff had in fact unsuccessfully attempted to contact the Association). See also CREEDNZ Inc. v Governor-General [1981] 1 NZLR 172 at 189, where the New Zealand Court of Appeal expressed the view that delegated legislation affecting particular interest groups had to be passed in accordance with the rules of natural justice in the particular statutory context under consideration.
themselves, as they were already in force and were being used by local authorities to administer the housing benefits scheme.\textsuperscript{25}

Although the court was not prepared to grant a remedy in that particular case, Webster J did make some useful comments on what would be required to fulfill a consultation requirement, noting that the concept of consultation involved both a genuine invitation to give advice and a responsible consideration of any advice given.\textsuperscript{26} Similar judicial reticence in relation to second-guessing the content and degree of consultation requirements in this area has also been evident in three recent decisions of the New Zealand Court of Appeal.\textsuperscript{27}


\textsuperscript{26} [1986] 1 All ER 164 at 167: "There is no general principle to be extracted from the case law as to what kind or amount of consultation is required before delegated legislation, of which consultation is a precondition, can validly be made. But in any context the essence of consultation is the communication of a genuine invitation to give advice and a genuine consideration of that advice. In my view it must go without saying that to achieve consultation sufficient information must be supplied by the consulting to the consulted party to enable it to tender helpful advice. Sufficient time must be given by the consulting to the consulted party to enable it to do that, and sufficient time must be available for such advice to be considered by the consulting party. Sufficient, in that context, does not mean ample, but at least enough to enable the relevant purpose to be fulfilled." For judicial discussions of the nature of the concept of "consultation" see \textit{Fletcher v Minister of Town and Country Planning [1947] 2 All ER 496 at 500; Re Union of the Benefices of Whippingham and East Cowes, St James [1954] AC 245}.

\textsuperscript{27} See \textit{New Zealand Fishing Industry Association Inc v Minister of Agriculture and Fisheries [1988] 1 NZLR 544; Wellington International Airport Limited v Air New Zealand [1993] 1 NZLR 671; Southern Ocean Trawlers Ltd v Director-General of Agriculture and Fisheries [1993] 2 NZLR 53}. In the first case the Court held that on the proper construction of the New Zealand Fisheries Act 1983 (as amended by the Fisheries Amendment Act 1986), the Minister of Agriculture and Fisheries, who was required under s 107G of the Act to advise of a proposed recommendation, invite submissions in respect of it and have regard to any such submissions, was not required to formulate his recommendation in consultation with the Fishing Industry Board or any industry party. As the Court noted at p 558: "The Minister simply has to consider and weigh any such submissions in the balance along with other factors referred to in subsection (7) in deciding what recommendation to make under subsection (1)." In the second case the Court held (at p 676), in relation to the fixing of airport company charges which the statute required be fixed "after consultation with airlines which use the airport" that meaningful consultation required that the consultee be provided with "sufficient information to enable it to be adequately informed so as to be able to make intelligent and useful responses." However a requirement of consultation in that context was not equivalent to negotiation as such, and the airport company in question was not required to enter into negotiations over the proposed charges in a manner exceeding its statutory obligations. In the last case the court held (at p 62) that there were no grounds for "importing the rather vague duty of consultation for which the appellant contends."
More recently, developments in the doctrine of legitimate expectation in United Kingdom administrative law have given rise to expanded rights of consultation, generally where public bodies attempt to alter or not apply existing policies in a manner that adversely affects individual rights. Under these circumstances courts have shown a greater willingness to require such bodies to consult with affected persons before changing the policy in question. These developments are significant and merit discussion in further detail.

(iii) The Influence of the Doctrine of Legitimate Expectation

In recent years administrative lawyers have become familiar with a new source of procedural, and even perhaps substantive, rights deriving from the doctrine of legitimate expectation. The relationship between this doctrine and the remedy of judicial review has been examined in some detail in the literature, and the rationale for and uncertain scope of the doctrine has been noted. In the present context it is useful to consider the extent to which the doctrine of legitimate expectation can operate so as to promote consultation and participation rights in relation to the

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29. See Elias, "Legitimate Expectation and Judicial Review" in Jowell & Oliver (eds), New Directions in Judicial Review (1988); de Smith, Woolf & Jowell, ibid, paras 8-037 - 8-066.

30. See de Smith, Woolf & Jowell, ibid, paras 8-037 - 8-038: "Since the early 1970s one of the principles justifying the imposition of procedural protection has been the legitimate expectation. Such an expectation arises where a person responsible for taking a decision has induced in someone who may be affected by the decision a reasonable expectation that he will receive or retain a benefit or that he will be granted a hearing before the decision is taken. In such cases the courts have held that the expectation ought not to be summarily disappointed. The scope of the legitimate expectation has been the subject of intense discussion; it is still in the process of evolution. It is founded upon a basic principle of fairness that legitimate expectations ought not to be thwarted. The protection of legitimate expectations is at the root of the constitutional principle of the rule of law, which requires regularity, predictability, and certainty in government's dealings with the public." [footnotes omitted]
making of delegated legislation and administrative rules. If there is scope for the application of the doctrine in this context, then the utility of the common law in this area would be greatly enhanced.

In considering this question, the general theme of the importance of consultation and participation rights in regulatory decision making, as expounded in chapter 5, should be kept in mind. As Galligan has aptly noted, the legitimacy of discretionary decisions in the administrative process is enhanced by the observance of these principles.\(^{31}\)

The case law on the doctrine of legitimate expectation illustrates that the courts themselves have not taken a unanimous view of the extent to which the concept affects procedural rather than substantive rights. Some courts have inclined to the view that the doctrine is procedural in nature,\(^{32}\) whereas others have taken a more

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31. See Galligan, *Discretionary Powers - A Legal Study of Official Discretion* (Clarendon Press, Oxford, 1986), p 337: "The first question is what sort of procedures contribute most effectively to rational outcomes. It might be thought that there are only two types of procedure, one associated with the political process, the other with adjudication. But we have seen that within discretionary authority, reasonably distinct types of decisions can in practice be identified; in section 7.31 this classification is matched to appropriate modes of participation. In particular, consultation is advanced as a mode of participation that generally is appropriate in relation to the policy aspects of discretionary decisions. In order to develop the notion of consultation it is necessary, because of the merging within the public law model of political and legal spheres, to analyse the relationship between areas of discretion and the general political system. The second issue concerns the role of participatory procedures; in discretionary contexts, because of the relative autonomy of administrative officials, participatory procedures are important in contributing to principles of good decision-making and accountability."

32. See for example *R v Secretary of State for Transport, ex parte Richmond Upon Thames LBC* [1994] 1 WLR 74, in which Laws J expressed the view (at pp 92-93) that the doctrine related only to procedural and not to substantive rights. For a similar decision in the Australian context see *Attorney-General of New South Wales v Quin* (1990) 170 CLR 1 at 23. For one view of the issue see Poole, "Legitimate Expectation and Substantive Fairness: Beyond the Limits of Procedural Propriety" [1995] NZ Law Review 426, arguing at p 446 that: "Legitimate expectation is and always was a procedural concept. It evolved to afford procedural protection to those classes of persons to whom procedural fairness did not automatically apply. The existence of a legitimate expectation, created by a representation or a past practice, should alert the decision-maker to the need to provide some procedural benefit; an opportunity to argue that the expectation should not be defeated for reasons known to the holder of the expectation and able to be argued in his or her case. That is all legitimate expectation can provide. The trend toward insisting that the substance of the expectation be honoured is misguided, and results in a serious distortion of the parent concept of procedural propriety or fairness." Craig, in his article "Substantive Legitimate Expectations in Domestic and Community Law", *supra* note 28, takes the opposite view, observing at p 310: "The recognition by Sedley J. that there can be substantive legitimate expectations is to be welcomed and it is to be hoped that this view will be endorsed by higher courts." See also Finn & Smith, "The Citizen, the Government and Reasonable Exceptions" (1992) 66 ALJ 139 at 150: "We merely query whether the administrative law position may not in time be brought into harmony with that in tort through
adventurous line and have been prepared to extend the doctrine to substantive matters.\textsuperscript{33} As we have seen, other courts have been reluctant to recognise any duty to act fairly in relation to procedural aspects of delegated legislation.\textsuperscript{34}

In the present context there seems little doubt that consultation requirements can be viewed as a procedural matter where the application of the doctrine of legitimate expectation may be feasible. There have indeed been cases where the court has been prepared to consider the application of the doctrine in such circumstances, with varying outcomes. In the well known \textit{GCHQ} case,\textsuperscript{35} the House of Lords considered whether the doctrine of legitimate expectation could be applied to the circumstances of civil servants who had claimed a legitimate expectation of consultation prior to withdrawal of their trade union membership. In the House of Lords, Lord Fraser was prepared to uphold the existence of a legitimate expectation of this kind,\textsuperscript{36} although this did not avail the appellants in the final result.

\textsuperscript{33} See for example \textit{R v Ministry for Agriculture, Fisheries and Foods ex parte Hamble (Offshore) Fisheries Limited} \citeyear{R v Ministry for Agriculture, Fisheries and Foods ex parte Hamble (Offshore) Fisheries Limited} \citeyear{Mulder v Minister van Landbouw en Visserij} \citeyear{Northern Roller Milling Co Limited v Commerce Commission} \citeyear{Pierson v Secretary of State for the Home Department}. The issue of whether the doctrine of legitimate expectation has substantive or merely procedural effect was expressly left open by the House of Lords in the recent case of \textit{Pierson v Secretary of State for the Home Department} \citeyear{Pierson v Secretary of State for the Home Department} at 606 per Lord Steyn. In that case Lord Steyn preferred to base his judgment on the fact that Parliament could be expected to legislate consistently with the rule of law. As his Lordship observed at p 607: "Unless there is the clearest provision to the contrary, Parliament must be presumed not to legislate contrary to the rule of law. And the rule of law enforces minimum standards of fairness, both substantive and procedural. I therefore approach the problem in the present case on this basis." The Court of Appeal took a more restrictive view in \textit{R v Secretary of State for the Home Department ex parte Hargreaves and others} \citeyear{R v Secretary of State for the Home Department ex parte Hargreaves and others}, holding that the application of the doctrine was restricted to procedural rights and did not extend to substantive ones. For a discussion of this decision see Foster, "Legitimate Expectations and Prisoners' Rights: The Right to Get What You are Given" \citeyear{Foster, "Legitimate Expectations and Prisoners' Rights: The Right to Get What You are Given"}

\textsuperscript{34} See \textit{Bates v Lord Hailsham}, \textit{Inuit Tapirisat of Canada v Attorney General of Canada} \citeyear{Inuit Tapirisat of Canada v Attorney General of Canada} \citeyear{Groupe des éleveurs de volailles de l'est de l'Ontario v Canadian Chicken Marketing Agency}, \textit{Council of Civil Service Unions v Minister for the Civil Service} \citeyear{Council of Civil Service Unions v Minister for the Civil Service}.\textsuperscript{35} \textit{Council of Civil Service Unions v Minister for the Civil Service} \citeyear{Council of Civil Service Unions v Minister for the Civil Service} AC 374.\textsuperscript{36} \textit{Ibid} 401: "Legitimate, or reasonable, expectation may arise either from an express promise given on behalf of a public authority or from the existence of a regular practice which the claimant can reasonably expect to continue...The submission on behalf of the appellants is that the present case is of the latter type. The test of that is whether the practice of prior consultation of the staff on significant changes in their conditions of service was so well established by 1983 that it would be unfair or inconsistent with good administration for the Government to depart..."
Several recent English decisions have given further consideration to the scope of consultation obligations in relation to delegated legislation. In a 1992 case involving regulations made by the Secretary of State for Health banning oral snuff, the single producer of the commodity which was directly proscribed by the regulations claimed that it had received permission some two years before the proposed regulations were made to set up its manufacturing facility on certain agreed conditions. It argued that the regulations had been made on the basis of a committee report on the apparent health risks associated with the product, but the regulations were then passed without giving it an opportunity to make submissions on them.

While conceding that the company had been "led up the garden path" under all the circumstances, the court held that no legitimate expectation arose given the Secretary of State's well known obligations to promote and safeguard public health. However the court was prepared to quash the regulations on the grounds that the Secretary of

37. R v Secretary of State for Health, ex parte United States Tobacco International Inc [1992] 1 All ER 212 (discussed in Schweb and Brown, "Legitimate Expectation - Snuffed Out" [1991] PL 163). For examples of other, similar cases, apart from those discussed in the text of this part of the chapter, see R v Brent London Borough Council ex parte Gunning (1985) 84 LGR 168; R v British Coal Corporation and Secretary of State for Trade and Industry, ex parte Price [1993] COD 482; R v Birmingham City Council, ex parte Dredger [1993] COD 340. In the Australian context the relevant authorities are summarised in the case of Consolidated Press Holding Limited and Others v Federal Commission of Taxation and Another (1995) 129 ALR 443 at 451 per Lockhart J: "It is well established in Australian administrative law that legitimate expectation may give rise to a duty to observe procedural fairness: see Haoucher v Minister for Immigration and Ethnic Affairs (1990) 169 CLR 648; 93 ALR 51; Attorney-General (NSW) v Quin supra note 32, and Century Metals & Mining NL v Yeomans (1989) 40 FCR 564; 100 ALR 383. It was observed in Haoucher and Quin that the presence of a legitimate expectation conditions the existence of a person's right to procedural fairness and the corresponding duty of the decision-maker to observe procedural fairness in the treatment of the person's claim or case. The content of the duty depends upon the circumstances of the particular case, but its existence is determined by the application of legal principle." See also the discussion in the judgment of the Appeal Division, Supreme Court of Victoria, in The State of Victoria v The Master Builders' Association of Victoria [1995] 2 VR 121. Recent Australian cases may well have overreached in terms of the ambit of the doctrine. See for example Minister of Immigration and Ethnic Affairs v Teoh (1995) 128 ALR 353, criticised in Taggart "Legitimate Expectations and Treaties in the High Court of Australia" (1996) 112 LQR 50.

38. Ibid 372 per Morland J.
State was obliged to act fairly towards the applicants and under the circumstances he
should have divulged the reasons for the recommended ban. 39

In a 1993 decision, 40 the Queens Bench division accepted the contentions of the Law
Society of England and Wales that it had a legitimate expectation of consultation by
the Lord Chancellor's Department in relation to the making of regulations governing
the UK legal aid scheme. There had been limited consultation with the Law Society
on certain aspects of the new regulations but the Law Society claimed that
consultation in relation to the crucial aspect of the public funding of the scheme had
been inadequate. The court held that under the circumstances the Lord Chancellor's
Department had undertaken reasonable consultation in relation to the proposed
regulations and that the regulations had been validly made. It is interesting that in
this case the court was prepared to conduct a limited cost-benefit analysis, balancing
the Lord Chancellor's desire to make the regulations on an urgent basis with the
possible benefits of consultation which might have resulted in amendments to the
proposals.41

In a decision given in September 1993, 42 the Queen's Bench Division was similarly
prepared to recognise that the doctrine of legitimate expectation could give rise to an
obligation of consultation.43 However the court, somewhat unsurprisingly, was not
prepared to elevate this right to the level of a substantive expectation that the policy

39. *Ibid* 372 per Taylor LJ: "Although the Regulations were subject to annulment by negative
resolution of the House of Commons but were not so annulled, Parliament would be concerned
only with the objects of the Regulations and would be unaware of any procedural impropriety. It
is therefore to the courts, by way of judicial review, that recourse must be had to seek a remedy."


41. See LEXIS copy of the judgment at pp 23-25.

42. *R v Secretary of State for Transport, ex parte Richmond upon Thames London Borough Council
and others*, supra note 32.

43. *Ibid* p 595: "...the public body in question may have adopted a particular policy, and, by promise
or past practice, represented that this would be its continuing policy. In this case, there is no
promise or past practice to the effect that those affected will be allowed a voice before the policy
is changed. But, if (and it will depend on the particular facts) the court concludes that there
exists what amounts to an assurance that the policy will continue, it may deem it unfair for the
authority to make a change in the policy unless it announces its intention in advance so as to
allow an affected person to make representations before any change is carried out."
in question would not be altered even after the process of consultation had been carried out. Laws J held that such a development would represent an unacceptable extension of the doctrine of legitimate expectation and would unreasonably fetter the discretion of administrative decision makers.\textsuperscript{44}

Some academic commentators have taken a relatively sanguine view of these developments.\textsuperscript{45} However, others such as Craig have pointed to the limitations inherent in the existing doctrine and have argued in favour of a more general recognition of the right to prior consultation.\textsuperscript{46}

In the context of economic regulation, there may be some scope for the application of the doctrine of legitimate expectation, particularly in relation to regulatory decision making. Given that the doctrine recognises that a representation can arise from a decision maker's previous practice, this would make it difficult for an economic regulator to "back track" on an existing consultation regime which had been an established and central part of the process of regulatory decision making up to that time. This would certainly be the case with economic regulators such as OFTEL and the Rail Regulator, who have put in place formalised consultation regimes. Such structured systems of consultation would arguably serve to distinguish such regulators

\textsuperscript{44} Ibid pp 596 - 697: "...but if (as it must be the case) the public authority in question is the judge of the issue whether "overriding public interest" justifies a change in policy, then the submission means no more than that a reasonable public authority, having regard only to relevant considerations, will not alter its policy unless it concludes that the public will be better served by the change. But this is no more than to assert that a change in policy, like any discretionary decision by a public authority, must not transgress \textit{Wednesbury} principles. That, however, is elementary and carries Mr Gordon nowhere."

\textsuperscript{45} See for example Small, "Legitimate Expectations, Fairness and Delegated Legislation" (1994) 8 CJALP 129 at 157: "To deny the concept of procedural fairness to the delegated legislative process is in principle objectionable. There is clear evidence that the courts in the United Kingdom are aware of this, and case law reveals a shift of focus: procedural fairness is concerned with the facts and the actual process followed, and it is now unlikely that any court in the United Kingdom would attempt to classify an action by a public authority as purely legislative in nature in order to deny relief. These developments have enabled the concept of fairness to flourish as an independent principle of implied procedural review."

\textsuperscript{46} See Craig, \textit{supra} note 5, pp 255-262. Such an approach arguably derives some support from Lord Steyn's views in \textit{Pierson, supra} note 33, although their application in the present context would depend upon the extent to which consultation and participation requirements were to be viewed as fundamental rights, an issue on which academic and judicial opinion tends to differ, as will be seen later in this chapter.
from decision makers who have sought to re-think or resile from informal or casual consultation procedures.\footnote{For an example of the latter see R v Secretary of State for the Environment, ex parte Kent [1988] JPL 706; affirmed [1990] JPL 124 (CA), where an informal practice of notifying neighbours of planning applications relating to adjoining properties was not sufficient to give rise to a legitimate expectation that a particular individual would be consulted. This case is discussed in de Smith, Woof & Jowell, supra note 28 at para 8-054, where the learned authors comment: "Not all past practice however may justify a legitimate expectation that the practice will continue."}

The ability of third parties, such as consumer interests, to invoke the doctrine in the context of regulatory processes is more problematic. It may be quite difficult for consumer representatives to bring themselves within the scope of the doctrine, given the need to show that a regulatory body has induced in them an expectation in sufficiently clear terms. Furthermore any legitimate expectation which does arise may well not provide any right to challenge a substantive regulatory decision as such.

Despite these difficulties the doctrine arguably serves to empower the common law in this area at a time when the possibility of passing general remedial legislation prescribing such rights may be more limited. If one accepts the proposition, which lies at the heart of this thesis, that the process of economic regulation only derives essential legitimacy from the incorporation into it of adequate consultation and participation mechanisms, then techniques of administrative law which may lead to the attainment of this goal are only to be welcomed.

(iv) Legislative Initiatives in Victoria, Australia

We therefore reach the position, at least in the United Kingdom, where requirements to consult in relation to the adoption of secondary and tertiary legislation must be derived from individual statutory authority, in the absence of a generalised consultation procedure such as that contained in the US APA, unless the court is prepared to recognise a legitimate expectation on the part of individuals to be consulted. Some Commonwealth jurisdictions have gone further than this. Two notable examples are provided by legislation in force in the state of Victoria in Australia and in the province of Quebec in Canada. To begin with the Victorian legislation, the Victorian
Subordinate Legislation Act 1962, as amended by the Subordinate Legislation (Review and Revocation) Act 1984, has prescribed general consultation requirements, with effect from 1 July 1985, in relation to the passing of subordinate legislation in Victoria.  

It is interesting to note that the Victorian Act was strongly influenced by the US APA and the American regulatory scene in general in terms of its Parliamentary history. The Legal and Constitutional Committee of the Victorian Parliament issued a lengthy report on the proposed legislation in September 1984. This report is of considerable significance in the present context as it represents one of the few detailed expositions by a Government body concerning the possible application of US APA type procedures in a Commonwealth jurisdiction.

In the course of its 474 pages, the report contained a detailed treatment of the evolution of delegated legislation in Victoria, and methods of Parliamentary control which have been exercised in this area in Australia and elsewhere. It also dealt in detail with the Australian experience with economic regulation and examines competing theories of regulation in other jurisdictions. In addition it explored in some depth both the United States and Canadian approaches to economic regulation and included a detailed treatment of US APA procedures and developments in the cost-benefit analysis of US regulations during the 1980s.

The Victorian report also examined the Canadian approach, noting the influence of US APA type procedures in some Canadian jurisdictions and the development of “notice and comment” type procedures in relation to federal, and some provincial, regulations.

48. For a discussion of the Victorian legislation see Craven, "Consultation and the Making of Subordinate Legislation - A Victorian Initiative" (1989) 15 Monash ULR 95; Kennan, "Administrative Law: Developments in Victoria" (1984) 58 Law Inst J 826. The only other Australian jurisdiction to have adopted similar procedures is South Australia, where the system in force is considerably weaker and largely operates without statutory support.

49. See the discussion in Craven, ibid, p 96.

50. Report on the Subordinate Legislation (Deregulation) Bill (Legal and Constitutional Committee, Parliament of Victoria, September 1984). I am grateful to my friend, Mr Tom Poulton, a partner in the Melbourne office of the Australian national law firm of Arthur Robinson & Hedderwicks, for providing me with a copy of this lengthy report together with some useful comments on the Victorian legislation.

passed in Canada since 1978.\(^\text{52}\) It also went into some detail on the justification for wide-ranging public consultation in relation to regulatory activities,\(^\text{53}\) placing considerable emphasis on consultative procedures as being an essential aspect of democratic government.\(^\text{54}\)

After considering existing consultation regimes, both in Australia and Canada, the Committee emphasised that sufficient resources need to be directed to ensuring that interested groups were fully able to participate in the consultation process.\(^\text{55}\) The resulting legislation attracted bi-partisan political support in the Victorian Parliament, a milestone in itself given the usually volatile nature of Australian state and federal politics, and introduced detailed consultation requirements in relation to subordinate legislation. Some of the noteworthy features of the Victorian legislation are as follows.

First, the Victorian Act applies to a broad range of "statutory rules". This term is defined so as to include not only traditional delegated legislation made by the Governor in Council, but also instruments of a legislative character which are declared by the Attorney General, in notices published in the Government Gazette, to be statutory rules. (Local Authority by-laws are however expressly excluded.) The Second Schedule to the Act sets out a number of guidelines pertaining to the content and passing of statutory rules. There is a noteworthy provision in paragraph 3(e) of the Second Schedule which requires consultation with appropriate representatives of industry, commerce, consumers, members of the public or the State in circumstances where a proposed statutory rule will be likely to impose any "appreciable burden, cost or disadvantage" on any such sector. This requirement was derived from US precedent.

\(^{52}\) Ibid pp 109-115.

\(^{53}\) Ibid pp 194-213.

\(^{54}\) Ibid p 194: "The Committee believes that not only should consultation be taken into account as ensuring that the people have a greater involvement in decision making than has been the case in the past, but also that it has a potential for making government more effective. This is nowhere more evident than in the area of regulation making."

\(^{55}\) Ibid p 210. The Committee noted at paragraph 89 on p 210 of its report: "In the Committee's view, it is important to ensure that public interest groups have access to the decision making process in the same degree as business and trade union groups. All interests which both require and deserve representation are not covered by 'business', 'trades unions' and 'government'. The Committee believes that it is important to build in to the regulation making process mechanisms which ensure that community interests are given full recognition, so that the concerns of the public in general are not overlooked, nor downgraded."
notably the cost-benefit requirements imposed under Reagan Executive Order 12,291, which has been discussed earlier, in chapter 6.\footnote{See the discussion in part 6.2.6 of chapter 6.}

Craven has noted that some of the provisions of the Victorian Act are drafted in vague terms (possibly deliberately so) and that observance of the legislation, at least in the initial stages, was somewhat lukewarm on the part of Ministers.\footnote{See the discussion in Craven, \textit{supra} note 48, pp 98-103 and pp 112-114. Craven notes at p 113: "... initial compliance by authorities with the impact statement process was clearly woeful, to the point where one is tempted to believe that many authorities would, if possible, have chosen simply to ignore the relevant requirements of the Subordinate Legislation Act. Indeed, even after over three years of the operation of those requirements, one-fifth of the rules requiring the preparation of an impact statement continue to be made in breach of the law. This is hardly a tribute to Victorian Government authorities."} Despite these various problems with the interpretation and implementation of the legislation, it appears that it has exerted a significant influence on the process of promulgating delegated legislation in Victoria and demonstrates what can be achieved by a general statutory provision operating in this area.

An attempt was made to enact similar legislation at the federal level in Australia and a Bill was introduced into the Federal Parliament on 15 March 1988, but was not passed.\footnote{This Bill was entitled the Delegated Legislation Review Bill 1988 and was introduced by Senator McLean of the Australian Democratic Party, a minority non-government party represented only in the Senate. The Commonwealth Bill was never passed and has now lapsed. (From details provided in a letter from Tom Poulton of Arthur Robinson & Hedderwicks to the writer dated 28 November 1995. I am grateful to my friend Mr Poulton for providing me with this additional information.)} The proposed Commonwealth Act would have required the preparation of regulatory impact statements for all delegated legislation and would also have put in place a joint committee on delegated legislation with responsibility for examining such legislation in terms of various statutory criteria. These criteria included, in clause 11(1)(j) of the Bill, whether or not there had been "adequate consultation with the public generally, or with interested classes of the public, concerning the proposed legislation before it was made."
The effectiveness of the Victoria regime was considered by the Administrative Review Council in a 1992 report on agency rule making. The Council, in its report, considered objections from regulatory agencies that the consultation requirements in the Victorian legislation were cumbersome and inefficient and led to unnecessary additional expenditure. It noted that the Victorian Legal and Constitutional Committee had advised that such assertions were not supported by definitive evidence and that agency tolerance of the Victorian procedures varied greatly in practice.

After considering the experience in Victoria and elsewhere, the Council considered that there should be statutory provision for formal consultation in respect of agency rule making at the federal level. It observed that the agencies were generally opposed to statutory consultation requirements on cost benefit grounds but considered that informal consultation posed an unacceptable risk of responses being tailored to the particular circumstances of the case.


60. Ibid para 5.18 on p 34: "Complaints have been made that the requirements are unduly onerous and costly and do not yield benefits commensurate with the cost of compliance. The process is said to be cumbersome and to impede the efficient operation of government by slowing the process for the making of necessary statutory rules...Agencies also assert that the response from the public is so limited on occasions that the expense of an impact statement is not justified."

61. Ibid para 5.19. The Council noted at para 5.23 of its report: "In summary, the Victorian procedures have gained acceptance and agencies are now working with the process rather than against it. While there appear to be many benefits from the process, the lack of hard statistical information makes any assessment somewhat subjective. Nonetheless, the Council is impressed with the overall approach to rule making in Victoria."

62. Ibid paras 5.28 - 5.30:

"5.28 The Council, however, has come to the view that there should be statutory provision for consultation. In most cases under present arrangements there is no guarantee of an opportunity for all interested parties to participate in an agency's rule making activities. Informal mechanisms tend to depend on the sponsoring agency contacting known groups. This runs the risk of 'captured consultation'. The groups known to the agency expect to be consulted and the agency will anticipate and seek their responses. Both parties develop an expectation about being consulted and the likely content of that consultation. Other points of view, however legitimate, are excluded by these arrangements.

5.29 Evidence from Victoria suggests that the cost burdens are offset by better instruments. In any case, if the consultation under current arrangements is as wide as agencies assert, a requirement to consult will in many ways be formalising the existing arrangements."
The Council recommended that Australian federal legislation should be adopted in the form of a proposed Legislative Instruments Act. This would stipulate compulsory public consultation in relation to subordinate legislation, subject to a range of specified exceptions. Such consultation would be 'first round' consultation only and agencies would not be required to embark on a subsequent round of consultation before producing the final version of the statutory instrument. (To this extent the Council's recommendations in this area run counter to the practice adopted by some British regulatory bodies such as OFTEL, which have favoured a two-tier process of consultation.)

5.30 The Council, therefore considers that the proposed Legislative Instruments Act should provide general consultation requirements for the making of all delegated legislative instruments.

Recommendation 9

The Legislative Instruments Act should provide for mandatory public consultation before any delegated legislative instrument is made, subject to the following exception:

- where the instrument provides for an increase or decrease in fees or charges and the increase or decrease does not exceed the amount set by the Budget;
- where the instrument is of a minor machinery nature, including savings and transitional provisions, and it does not fundamentally alter the existing arrangements;
- where the Attorney-General certifies that an Act empowering the making of delegated legislation provides for consultation comparable to that required by the Legislative Instruments Act;
- where advance notice of a particular legislative rule would enable individuals to gain advantage that would otherwise not accrue;
- where the Attorney-General certifies that the public interest requires that consultation should not be undertaken in a particular case. Any certificate so issued should be tabled in the Parliament with the instrument and should state the grounds of public interest relied on; and
- where the instrument contains rules of court which in accordance with recommendation 30 the court has determined in the public interest should be made without consultation.

Recommendation 10

The Legislative Instruments Act should require agencies to undertake 'first round' consultation only. Any further consultation should be at the discretion of the agency.

See the discussion of the OFTEL consultation regime in part 9.2.2 of chapter 9.
As in the case of the Quebec legislation discussed below, the Council recommended that the nature and content of the consultation requirements in the proposed federal legislation should be left open as a matter that individual agencies should determine, having regard to the circumstances and degree of complexity of individual rule making initiatives. The Council recommended that a proposed rule making would be publicised by publishing the draft instrument and an accompanying ‘Rule Making Proposal’ in daily newspapers and appropriate trade and professional journals. The accompanying proposal would be in two parts, the first of which would contain a summary of the proposal and refer to its objectives whereas the second would analyse alternative means by which the proposal might be achieved (including the possibility of using non-regulatory means), together with an estimated cost for the proposal.

The second part would also contain reasons for the approach preferred by the agency in question. At least 21 days would be allowed for submissions to be made on the draft instrument, public hearings would be held for “controversial or sensitive proposals” and all submissions made would have to be taken into account by the relevant agency. The final form of the instrument to be tabled in Parliament would be required to be accompanied by a memorandum from the responsible agency confirming that the prescribed consultation procedures had been followed and annexing a copy of the “rule making proposal” relating to the particular instrument. Unfortunately to date the Council’s recommendations appear to have proved too radical for adoption and Australian federal legislation reflecting these proposals has yet to eventuate.

Despite this legislative inertia at the Australian federal level, there would seem to be no good reason why similar, general legislation to that in force in Victoria and proposed by the Australian Administrative Review Council, should not be adopted in the United Kingdom and in other Commonwealth jurisdictions. While the impetus for the

66. See part 8.2.2(v) to this chapter.
67. See the Council report, supra note 59, Recommendation 11 on p 41.
68. In jurisdictions such as New Zealand the courts have sometimes been prepared to take a liberal view of consultation requirements, upholding the necessity for consultation by decision making bodies even where such bodies were permitted to act independently. See for example Elston v State Services Commission [1979] 1 NZLR 193; Hamilton City Council v Waikato Electricity Authority [1994] 1 NZLR 741 at 762. In cases where statutory instruments have affected the livelihood of persons working in a particular area (such as the effect on fishermen of changes in the system for the allocation of fishing licences) the New Zealand Court of Appeal has been
Victorian legislation arose out of experience at the federal level in the United States and Canada, in the end the Australian legislative initiatives in this area have been confined to the state level in Victoria. Legislative efforts at the federal level have not come to fruition in Australia. Nevertheless, the fact that such legislation can be satisfactorily introduced at the state level in Australia shows that, given the will to do so, similar legislation could be adopted by a unitary law making body such as the UK Parliament. If such a proposal ever finds favour in Britain then the Victorian experience may provide a useful model for legislation in this area.

(v) The Quebec Legislation

In Canada, the issue of federal review of subordinate legislation has been the subject of periodic consideration and has been addressed in two significant federal government reports, the McRuer and the MacGuigan reports. At the federal level, the problem has been addressed to date by including specific consultation requirements in individual federal statutes and by the introduction of administrative reforms. The latter have included a general practice of making draft subordinate legislation available for public consultation and comment. This process has recently been formalised at the federal level by the regular publication of *Regulatory Agendas* containing draft statutory instruments and rules and by the adoption of formal consultation guidelines for the prepared to recognise an obligation on the part of the relevant Minister to receive submissions from the parties directly affected before issuing the relevant statutory notices. See for example *Fowler and Roderique Ltd v Attorney-General* [1987] 2 NZLR 56; *Gallagher v Attorney-General* (unreported, High Court, Wellington, Ellis J, 28 July 1988). For a general discussion of the New Zealand position in this area see Joseph, *Constitutional and Administrative Law in New Zealand* (The Law Book Company Ltd, Sydney, 1993), pp 752-756.


70. These federal initiatives are summarised in Evans et al, *ibid*, pp 233-237 and were also discussed in a 1988 report by the Ontario legislature entitled *Second Report 1988* (Ontario Standing Committee on Regulations and Private Bills, 1988, under the chairmanship of David Fleet MPP, more commonly known as the *Fleet Report*). For a general discussion of the Canadian reforms at the federal level see *Report on the Subordinate Legislation*
federal public service.\textsuperscript{71} However it has been at the provincial level that the main statutory innovations have occurred in this area in Canada. In the Province of Quebec, Canada, general requirements as to consultation have been prescribed by legislation for more than ten years and the Quebec experience will now be examined.\textsuperscript{72}

The Quebec legislation followed a long tradition of including consultation requirements in individual Quebec statutes, a practice which had in turn arisen in part from the unique bi-cultural situation existing in that province. The scheme of the legislation is to require official publication of proposed regulations, with such publication being accompanied by notification of the period within which submissions can be made on the draft instruments to nominated departments. The minimum period allowed for submissions is 45 days but a longer period may be allowed for in the official publication of the regulations or in terms of the statutory power under which the particular regulation is being made.\textsuperscript{73} The legislation permits prior publication and the ensuing period of consultation to be dispensed with in certain circumstances, such as cases of emergency and fiscal measures, provided that the reasons for such a step are themselves publicly notified.\textsuperscript{74}

In some respects the Quebec regime resembles that which is prescribed under the US APA, where agency rules are published in the US Federal Gazette. The Quebec legislation provides for a generally applicable statutory regime, unlike the case at the Canadian federal level. However the Quebec statute leaves the manner of consultation open-ended and does not seek to detail the nature or content of the obligation to

\begin{footnotesize}
\begin{enumerate}
\item Regulations Act, S.Q. 1986, c. 22.
\item See sections 8-11 of the Quebec legislation, \textit{ibid}. Draft regulations are required to be published in the \textit{Gazette officielle du Québec}. For a general description of the Quebec legislation see Evans et al, \textit{supra} note 69, pp 231-233; Craven, "Consultation in Rule-Making - Some Lessons from Australia" (1990) 4 CJALP 221 at 239-241. The position in Quebec prior to the passing of the 1988 Act is described in Barbe, \textit{Reglementation} (Wilson & Lafleur, Montreal, 1983), chapter 11.
\item See s 12 of the Quebec legislation, \textit{supra} note 72.
\end{enumerate}
\end{footnotesize}
consult. As in the United States, the fact that the Quebec system is statute-based would seem in theory to leave open the option of a challenge by way of judicial review if the statutory requirements were not observed. However, provided that actual notification in terms of the statute was made, it would be difficult to challenge regulations on the basis that inadequate consultation was entered into given the absence of any detail in the statutory provisions governing the consultation process itself.

The Canadian situation therefore reveals at least two parallel systems of consultation in relation to subordinate legislation and rule-making. At the federal level, non-statutory but relatively detailed consultation procedures are prescribed as a matter of administrative practice. At the provincial level in Quebec the obligation to consult is statutory in nature but is quite general in its application. The Quebec legislation appears to have operated satisfactorily in practice and shows that statutory prescription of consultation requirements need not be a phenomenon which is confined to the United States experience.

(vi) Parliamentary Control Over Secondary and Tertiary Rules

While on the subject of controls over the use of secondary and tertiary rules by the Executive and by administrative agencies, some mention should be made of requirements to lay such instruments before Parliament in order to subject them to prior scrutiny by the legislature. As will shortly be seen, this process has been accompanied by a remarkable degree of informality in the United Kingdom context.

Section 4 of the Statutory Instruments Act 1946 sets out the procedure to be followed where a statutory instrument “is required to be laid before parliament after being made.” Similar provisions are in force in other Commonwealth jurisdictions.75 In general, the requirement to have delegated legislation laid before Parliament has been

left to individual statutes, and has really only developed in the years since the end of the Second World War.\textsuperscript{76} There are now a number of statutes of a regulatory nature which prescribe formal laying requirements in relation to delegated legislation.\textsuperscript{77}

While these procedures may be reasonably well defined in the case of delegated legislation, they are less clearly articulated in relation to tertiary rules. The Statutory Instruments Act 1946 does not apply to such rules and in any event existing Parliamentary procedures are hardly able to cope with the heavy volume of statutory instruments now being generated, let alone the much larger number of tertiary rules of various kinds.\textsuperscript{78} In the United Kingdom context, controls over tertiary rules are complicated by the fact that there are no clearly defined statutory procedures of general application dealing with the issuing of such rules or prescribing procedural requirements for their validity. Similarly judicial review procedures in this area are characterised by a generally more inhibited approach compared with US practice, as commentators such as Asimow have noted.\textsuperscript{79}

\begin{itemize}
\item \textsuperscript{76} For a general discussion of the origins and nature of Parliamentary tabling requirements for delegated legislation see Baldwin, \textit{supra} note 1, pp 62-69; Griffith, "Delegated Legislation - Some Recent Developments" (1949) 12 Mod LR 297; Hayhurst and Wallington, "The Parliamentary Scrutiny of Delegated Legislation" [1988] Pub Law 547; Craig, \textit{supra} note 5, pp 250-254.
\item \textsuperscript{77} In the social welfare area, see for example s 190(1) of the Social Security Administration Act 1992, which provides that: "Subject to the provisions of this section, a statutory instrument [made under various sections of the Act] shall not be made unless a draft of the instrument has been laid before Parliament and been approved by a resolution of each House of Parliament."
\item \textsuperscript{78} For a discussion of the difficulties of Parliamentary control over quasi-legislation or tertiary rules see Ganz, \textit{Quasi-legislation: Recent developments in secondary legislation} (Sweet & Maxwell, London, 1987), chapter 3; Baldwin, \textit{supra} note 1, pp 107-111.
\item \textsuperscript{79} Asimow, "Delegated Legislation: United States and United Kingdom" (1983) 3 OJLS 253 at 269: "Britain seems much less oriented toward using litigation to settle disputes, particularly those in which official discretion is questioned or in which political overtones are present. Instead, it seems that such disputes are usually settled quietly through compromise rather than through courtroom confrontations or resolved through conventional political processes. While British judges undoubtedly feel less restrained in second-guessing discretionary decisions, especially those made by local government officials than in years past and while the wave of American judicial interventionism has certainly receded from its crest, the difference in attitude and custom remains enormous." See also Beaton, "Legislative Control of Administrative Rulemaking: Lessons from the British Experience" (1979) 12 Cornell Int LJ 199 at 226: "The British experience clearly demonstrates that legislative control of rulemaking is rarely effective in resolving issues of policy and that there is little interest in legislative scrutiny, especially of technical defects. If vetoes are to be used at all, they should only be used where they are likely to be effective."
\end{itemize}
While public law litigation, using the techniques of judicial review, has grown in popularity in Britain in more recent years, the views of commentators such as Asimow retain an essential validity. These difficulties point towards the need for a more clearly defined regime for the issue of quasi-legislative instruments of this nature. While the desirability of allowing for flexibility in this area is one consideration, the price of such flexibility can prove to be too high if it is paid at the expense of a lack of accountability and of a principled basis for the making of such rules.

8.2.3 Use of Tertiary Rules in Certain Areas

(i) Codes of Practice

In the United Kingdom context, tertiary rules of various kinds have gained increasing popularity in recent years. One prominent example has been the increasing use of Codes of Practice in various contexts. These codes can vary in their binding effect, depending upon their statutory basis. Some, such as the Highway Code, are not legally binding in the sense that a breach of the code gives rise to criminal proceedings, but the existence of such a breach may be a factor which can assist in establishing negligence in a civil action. Other codes have been given greater enforceability. In the occupational health and safety field for example, codes issued under the Health and Safety at Work Act 1974 and approved under that Act by the Health and Safety Commission can be used to assist in proving a breach of the Act where there has been a failure to observe the Code provisions. A similar approach was taken in relation to the codes of practice issued under the Control of Pollution Act 1974 and the

80. For a general discussion of the use and effect of Codes of Practice in the United Kingdom see Ganz, supra note 78, chapter 2; Baldwin, supra note 1, pp 80-85.


82. See Health and Safety at Work Act 1974, s 17(2). For a general discussion of UK rule making initiatives in this area see Baldwin, supra note 1, chapter 5.
Employment Act 1980. Other codes are either voluntary in their effect or have more indirect legal effect.

In the area of social regulation, codes of practice have been in force for some time. The Commission for Racial Equality and the Equal Opportunities Commission have both issued codes of practice pursuant to the powers contained in the Race Relations Act 1976 and the Sex Discrimination Act 1975 respectively.

It is interesting to note in this context the influence which American practice has exerted, especially in the Equal Opportunities area. In the United States, the Equal Employment Opportunity Commission (EEOC) first issued guidelines on employment testing procedures in 1966, with the intention of encouraging consistency in agency adjudication proceedings and providing guidance on the interpretation of Title VII of the Civil Rights Act 1964. Initially these guidelines were treated by the EEOC as being interpretative and therefore not subject to the notice and comment procedures in the US APA. However, since 1977 the EEOC has followed the APA notice and comment procedures in relation to subsequent guidelines which it has issued.

In the United Kingdom context, Parliament appreciated that the publication requirements in the Statutory Instruments Act 1946 were not strictly applicable to guidelines such as those issued by the Equal Opportunities Commission and the

83. See Control of Pollution Act 1974, ss 31(9), 60(4), 72(6); Employment Act 1980, s 3(8).

84. For a discussion of examples of these see Ganz, supra note 78, pp 16-18.

85. For a discussion of these developments see Ellis, Sex Discrimination Law (Gower, Aldershot, 1988), pp 274-275; West Midlands Passenger Executive v Singh [1988] 2 All ER 873, upholding the decision of the Employment Appeal Tribunal [1987] IRLR 351, which had confirmed the legal enforceability of the monitoring provisions contained in the Race Relations Code of Practice issued in 1983 and which had statutory effect under s 47 of the Race Relations Act 1976; Sacks, "The Equal Opportunities Commission - Ten Years On" (1986) 49 Mod LR 560 at 571; McCrudden, "Regulations and Thatcherism: Some British observations on instrument choice and administrative law" (1990) 40 UTLJ 542 at 546-547.


87. It will be recalled from the discussion in chapter 6 that rules of an interpretative nature are exempted from the APA notice and comment requirements under §553(3)(A) of the US APA. See also the discussion in Albemarle Paper Co v Moody 422 US 405 at 452 (1975).

88. See Blumrosen, supra note 86, pp 324-325.
Commission for Racial Equality. Specific provisions were inserted in the relevant legislation providing for the preparation and publication of draft Codes of Practice by the EOC and CRE, with representations on the drafts to be received and considered and modifications made as a consequence. It is noteworthy that both Commissions were also required to consult with employers and workers associations and organisations and such other bodies as they considered appropriate.\(^8^9\)

To this extent the mechanism for the adoption of codes of practice in this area has embodied some of the features of rule making under the notice and comment procedures in the US APA. However the experience with the practical implementation of the consultation process in the United Kingdom in this area has unfortunately not been completely satisfactory. The Department of Employment adopted a somewhat sceptical view when a draft code was promulgated in 1980 and raised a number of objections to some of the code provisions, especially those dealing with training, ethnic monitoring, positive action and language training. It expressed a preference for a shorter and less specific code, arguing that the proposed code was too lengthy and detailed.

Further complications arose in 1982 when the House of Commons Select Committee on Employment advised the Secretary of State that it wished to have the opportunity of examining the draft code before it was approved and laid before Parliament. In the ensuing Select Committee hearings it became clear that the Committee was opposed to a number of the Code provisions and a period of intensive lobbying by various interest groups ensued. The Race Relations Code of Practice eventually came into force, after protracted delay, on 1 April 1984, while the Sex Discrimination Code of Practice took effect on 1 May 1985. Despite some changes to their final form the basic elements, including the highly controversial issue of ethnic monitoring, remained in place.\(^9^0\)

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\(^8^9\) See Race Relations Act 1976, s 47; Sex Discrimination Act 1975, s 56A.

\(^9^0\) For a discussion of these political difficulties accompanying the adoption of the Code see McCrudden, "Codes in a Cold Climate: Administrative rule-making by the Commission for Racial Equality" (1988) 51 Mod LR 408, 417-426.
(ii) Problems with the use of Codes of Practice

The experience with the adoption of these two Codes of Practice illustrates some of the practical difficulties inherent in gaining acceptance of processes involving independent administrative rule making by specialised agencies in the United Kingdom context. This is symptomatic of a wider reticence in Britain towards the adoption of rule making procedures generally, as commentators such as McCrudden have observed. Under the US APA procedures, the codes of practice would have been the subject of intensive input and lobbying by interested parties following the publication of the draft rules. However the APA procedure, despite its attendant delays and the possibility of protracted challenges by way of judicial review, would nevertheless have given rise to rules which in the final event were adopted in a transparent manner.

The areas of social legislation described above did of course attract considerable political controversy initially, and such controversy has tended to resurface from time to time in subsequent years. As will be seen in the following chapter, there is, however, scope for greater optimism in more recent times that structured consultation procedures in the area of economic regulation will prove to be more effective and can operate without ostensible political interference. The example of the CRE and EEO codes does however, illustrate the difficulties which can arise where relatively informal consultation provisions are adopted in the absence of a statutory scheme authorising the regulatory agency to achieve finality in relation to the form of the regulatory instrument to be adopted. The lack of finality inherent in informal processes of this kind has been

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91. McCrudden, *ibid*, p 434: "The unwillingness of the Select Committee and the Secretary of State to allow consultation by the C.R.E. to be seen as in any way an adequate substitute by them is no doubt partly explainable for this reason but it also demonstrates the difficulty which the British political system has in adapting to the concept of pluralistic decision-making inherent in setting up American-type regulatory agencies with rule-making powers."

92. A topical recent example, in late 1995, has been the somewhat strident interchanges of opinion between the President of the Law Society, Mr Martin Mears and his own council member, Ms Kamlesh Bahl, who also happened to be the Chairperson of the Equal Opportunities Commission, over the proper role of sex discrimination regulation, and indeed (at least in Mr Mears' view) whether in fact it had any role at all! See Mears, "Justice, law and abuses" (1995) 92 LS Gaz. (No. 38), 25 October 1995, p 12.
the subject of much adverse comment to the writer by representatives of industry
groups involved in the process of economic regulation.93

(iii) What Level of Consultation is Desirable?

The other difficulty with the widespread adoption of tertiary rules in the area of
economic regulation is that mandatory consultation requirements for all such rules may
have the effect of stultifying the regulatory process. In particular, non-legislative rules
which are purely interpretative in nature, or which are of procedural significance only,
should arguably not be subjected to formal consultative requirements. Even under the
US system, tertiary rules of this kind are exempted from the APA requirements.94

The merits of the arguments for and against subjecting such rules to the APA
procedures have been extensively canvassed in the United States. Some US
commentators have expressed the view that allowing the widespread use of these
instruments on the part of regulatory agencies can serve to defeat the democratic
objects underlying the APA procedures. Professor Anthony, for example, argues that
agencies should not seek to issue binding rules in a manner which is outside the APA
framework, except possibly in the case of purely interpretative rules where the agency
is only seeking to explain areas of vagueness in the existing statutory language.95

Similar sentiments have been expressed by the Administrative Conference of the
United States, which adopted a recommendation in June 1992 that agencies should not

93. See for example the views expressed to the writer by representatives of competitors of BT in the
UK Telecommunications industry as set out in part 9.2.2.(ii) of chapter 9.

94. See the discussion in Breyer and Stewart, Administrative Law and Regulatory Policy (Little,
Administrative Rulemaking: An analysis of legislative and interpretative rules" (1976) 29 Admin
LR 367; Anthony, "Interpretative Rules, Policy Statements, Guidances, Manuals and the Like:

95. See Anthony, ibid, p 1373: "Values served by the legislative rulemaking procedures are large
ones. Fairness is furthered by giving notice to those who are to be bound, both when the
proposed rule is about to be considered and when the final rule is definitively published... The
acceptability and therefore the effectiveness of a final rule are elevated by the openness of the
procedures through which it has been deliberated and by the public's sense of useful
participation in a process that affects them. Its legitimacy rests upon all of these considerations,
as well as upon the foundational fact that the agency has observed the procedures laid down by
Congress for establishing rules with the binding force of law."
seek to issue or impose binding standards or obligations, including binding policy
statements, without using APA rule making procedures, particularly the notice and
comment process. The ACUS further recommended that the preamble to legislative
rules should state that the rule is intended to be binding and should also recite the
specific statutory authority for the rule and the steps which the agency has taken to
comply with the procedural requirements for agency rule making. Other
commentators have taken a less rigid view, recognising that, as a matter of expediency,
measures to promote agency rule making by allowing the issue of a wider range of
instruments without the need to invoke the strict APA procedures may be one way of
counteracting the increasing ossification of the rule making process.

Some academic writers have suggested an *ex post facto* procedure whereby rule makers
should be required to publish tertiary rules and to receive comments on them within a
fixed period after the rule has been issued. As Baldwin has pointed out, such a
procedure has certain attractions. In particular it would avoid delay in the adoption of
tertiary rules while still allowing for consultation and public input at a subsequent
stage. However there are obvious difficulties with trying to persuade a regulatory
agency to make fundamental changes in its approach once rules have been adopted and
published. There may also be difficulties in defining which classes of rules are exempt,
and demarcation problems of this nature have not been uncommon in US experience.

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96. See Administrative Conference of the United States, *Recommendation 92-2: Agency policy
statements* (1 C.F.R. §305.92-2, adopted June 18, 1992).

97. See for example Pierce, "Seven Ways to Deossify Agency Rulemaking" (1995) 47 Admin LR
59 at 84-86. However even Pierce is doubtful as to whether the benefits flowing from
deossification of the rulemaking process in this way serve to outweigh the loss of the social
benefits arising from insistence on the use of notice and comment procedures in the course of the
rulemaking process.

98. See Baldwin, *supra* note 1, pp 112-114.

99. For some examples see *American Hospital Association v Bowen* 834 F 2d 1037 (DC Cir. 1987)
at p 1045 per Wald, Chief Judge ("...the spectrum between a clearly interpretative rule and a
clearly substantive one is a hazy continuum..."); *Community Nutrition Institute v Young* 818 F
2d 943 (DC Cir. 1987) at p 951 per Starr Circuit Judge (concurring in part and dissenting in
part) and Mikva and Edwards, Circuit Judges, ("It is thus, in theory, important for APA
procedures to be followed before an agency pronouncement is deemed a binding legislative rule
not merely because the APA says so, but because in saying so the APA is protecting a free
people from the danger of coercive state power undergirding pronouncements that lack the
essential attributes of deliberativeness present in statutes..."); *Air Transport Association of
America v Department of Transportation* 900 F 2d 369 (DC Cir. 1990), reversed 111 S Ct 944
Nevertheless some form of mandatory consultation requirement in relation to tertiary rules seems highly desirable.

There have been some areas of UK regulatory activity, such as land use planning and development control, which have enjoyed something of a tradition of adopting innovative techniques in terms of public consultation and the use of consensual procedures. These techniques have included the use of public inquiries. The general approach in this area has been preserved under the Town and Country Planning Act 1990, which has continued to place emphasis on the use of consensual procedures such as planning agreements. In the UK the area of economic regulation has recently witnessed the increasing voluntary adoption of structured consultation procedures by industry regulators. These developments will be examined in greater detail in the next chapter.

8.3 The Desirability of APA Type Procedures in UK Economic Regulation

8.3.1 The Need for Transparency and Provision of Information

(i) Two Aspects of the Problem

The concepts of transparency and the provision of information are of central importance to this thesis. They are relevant in two major respects. The first is that regulatory processes and determinations in the sphere of economic regulation in the United Kingdom should be open and free from secrecy of operation. The process of evolution of consultation and participation procedures, which is becoming increasingly evident in the utilities regulation area, should be encouraged. Regulators should be required to issue reasoned decisions or determinations and these should be amenable to a meaningful system of judicial review. The other side of the coin is that the provision of information and transparency of operation are not issues which solely concern regulatory bodies. Regulated interests, particularly those which enjoy a greater or lesser degree of monopoly power, may not be anxious to reveal intimate financial or

100. See the discussion of these aspects of the 1990 Act in Ball and Bell, supra note 16, and in de Smith, Woolf and Jowell, supra note 28, chapter 22.
operational details of their business which may enable the regulatory process to control their activities more effectively.

In the United Kingdom context it is difficult to overstate the importance of these considerations. Government processes in Britain have traditionally been characterised by excessive secrecy, both in absolute terms and by comparison with other Western democracies. This culture was (and to a large extent perhaps still is) encouraged by a bureaucracy which was reluctant to expose the processes of government to public scrutiny and which did not hesitate to use the full force of the law to achieve its aims, both by resort to wide ranging and draconian powers such as those contained in the Official Secrets Acts and elsewhere. Some commentators point to the problem of government secrecy as constituting a central barrier to the processes of regulation. Professor Prosser, for example, has highlighted the problem of behind the scenes political intervention in the UK regulatory process, a phenomenon which was clearly in evidence during the era of the nationalised industries.

(ii) Relationship to Regulatory Independence

Under the present system for the regulation of public utilities in the UK the possibility remains for covert government intervention in the regulatory process. Many of the regulatory decisions taken in various areas have obvious political repercussions, some recent examples being arrangements for rail ticketing sales, minimum standards of rail

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101. For a discussion of these underlying tendencies see Birkinshaw, Government and Information: The Law Relating to Access, Disclosure and Regulation (Butterworths, London, 1990), chapters 1 and 2; Birkinshaw, Harden and Lewis, Government by Moonlight (Unwin Hyman, London, 1990), chapter 7.

102. See Prosser, "Regulation of Privatized Enterprises: Institutions and Procedures" in Hancher and Moran, Capitalism, Culture, and Economic Regulation (Clarendon Press, Oxford, 1989), chapter 6, p 158: "However, especially in comparison to the United States, there is a marked absence of provisions requiring openness and debate before decisions are taken. Even more importantly, there is an almost total lack of openness in the decisions taken by government rather than by the new regulators. Even though I have suggested that important lessons could be learned from regulatory bodies in the United States, this suggests that the fundamental problem lies not so much with the regulatory bodies themselves but with the peculiar secrecy associated with British government. Whilst that remains, it is unlikely that privatisation will resolve the problems that were so characteristic of British nationalisation." For a discussion of government intervention in the management and policy decisions of the nationalised industries see the discussion in part 2.6.2 of chapter 2.
passenger service, electricity and gas pricing regimes and disconnection policies. Similarly some of the regulators have not hesitated to express forthright views on government policies (and on the policies of the then Labour Opposition) in certain areas, in ways which have provoked comment from politicians. Thus, the former Conservative government expressed some disquiet at the Rail Regulator’s original proposals to restrict the availability of through-ticket purchases. Members of the Labour shadow cabinet, when Labour was in opposition, have similarly not minced any words in relation to regulatory issues.

In practice, the ability of a government to influence regulatory policy under the existing statutory framework may be more limited. The legislation appointing the utility regulators, for example, also contains express provisions restricting the manner of their removal to the limited grounds of incapacity or misbehaviour. It would be very difficult, if not impossible, to argue that ideological differences with government policy are sufficient to fulfil these statutory criteria. Furthermore, as the recent example of Mr Lewis, the former Head of the Prison Service, and his very public contretemps with the then Home Secretary, Mr Michael Howard, over the removal of Mr Lewis from office during October 1995 illustrated, agency heads are nowadays less willing to go quietly when they consider that they have not been justly treated.

103. See the discussion on this point in part 7.6.1(ii).

104. Hain, Regulating for the Common Good (GMB Union Discussion pamphlet, April 1994), p 22. "The very existence of Regulator discretion means even the existing system could be deployed in favour of alternative policies where competition is not at the expense of social, economic or industrial objectives. An incoming Labour Government should immediately appoint new regulators with a different ideological remit and thereby begin to change the direction of the utilities."

105. See for example Electricity Act 1989, s1(3); Water Act 1989, s5(3); Gas Act 1986, s1(3); Railways Act 1993, s1(3); Telecommunications Act 1984, s1(3). Judges, who hold tenure under similar conditions, have provided some illustrative case law in this area, and in their case a high standard of proof of allegations of misbehaviour has been required. See for example the cases summarised in Todd, Parliamentary Government in England (1869), Vol II, p 746 ff; Attorney General v Mr Justice Edwards (1891) 9 NZLR 321 at 375. By way of an historical aside, King James I tried valiantly to find a charge of misbehaviour to bring against Chief Justice Coke, but in the end the best that he could do was to allege that Coke had diminished the royal prerogative by statements made in his series of law reports, a charge which Coke was readily able to refute. See Hood Phillips and Jackson, Constitutional and Administrative Law (Sweet & Maxwell, London, 7th ed, 1987), p 387, fn 99.)
Another illustration is provided by the recent reluctance of the former National Heritage Secretary, Virginia Bottomley, to dismiss the Lottery Regulator, Mr Peter Davis, during December 1995 for conduct which was demonstrably inappropriate, though stopping short of being dishonest.\textsuperscript{106} A further area in which a potential collision between politicians and the regulator may occur in the possibly not too far distant future is the field of telecommunications policy,\textsuperscript{107} where some of the regulator’s policies have attracted controversy at the political level.\textsuperscript{108}

It may well be true to assert, as commentators such as Mr Hain do unreservedly, that the utility regulators’ decisions are essentially political in nature. Certainly there can be little room for dispute that decisions on matters such as pricing, distribution and profitability, which can alter the relative status (and wealth) of parties with differing interests in the regulatory process, such as shareholders, utility managers, consumers, disadvantaged groups, environmentalists and so on, have clear political undertones.

Directions in the form of government guidelines (or in even stronger terms) may not necessarily be inherently unacceptable providing that the process is conducted openly and in accordance with statutory authority. However, if the above policies were to be adopted by the new Labour government significant changes to the legislation governing the privatised utilities would be required. It is well known that governments, once in

\textsuperscript{106} For a discussion of these events, including the nature of the relationship between Mr Davis and the American lottery company G-Tech, the owners of Camelot, see part 7.2.1 of chapter 7.

\textsuperscript{107} See article in The Times, Thursday, 2 November 1995: "OFTEL says BT-Labour link is monopolistic" recording that the Director General of OFTEL, Mr Don Cruickshank, had announced publicly on 1 November 1995, in the course of a radio interview, that he considered that the then recently announced Labour Party proposals to develop an information superhighway for schools solely with British Telecom were monopolistic in nature. He considered that schools should be given a choice as to whether or not they wished to connect to BT. The Regulator followed up on this theme shortly afterwards at a conference in Cambridge on Education Superhighways, held on 13 November 1995, by putting forward his own suggestions as to the use of computer technology in schools. Mr Cruickshank proposed the establishment of a universal service fund to be financed by network operators themselves. Providers of the services to schools would be reimbursed from this fund in proportion to their expenses. In his view this would guarantee a range of services to educational institutions, including predictable tariffs, affordable connections, internal networking and end-user kits. See also article in The Times, 14 November 1995: “Watchdog spells out vision for Internet.”

\textsuperscript{108} See, for example, Mr Peter Hain MP in his paper and accompanying remarks Who Regulates the Regulators?, (AIC Conference on Regulation and the Regulators, 2 November 1995, Park Lane Hotel, London), who took the view that the role of the regulators was undeniably political in nature and their pronouncements had obvious political ramifications.
power, not uncharacteristically exhibit greater reticence in effecting fundamental legislative changes than their pre-election statements may suggest. Furthermore, in his discussion paper, Mr Hain has rejected the possibility of a return to the days of the Morrisonian public corporation with its well known attendant failings. It does appear likely that economic regulation under Labour will involve closer government input in areas such as policy and standard setting and there are signs that such an approach is already becoming evident.

8.3.2 The Usefulness of APA Type Procedures in Compelling the Provision of Information by Regulated Interests

(i) The Nature of the Problem

As well as assisting to overcome secrecy in Government through the compulsory adoption of more transparent procedures, one of the other great advantages of the use of structured APA type procedures is the conceivable ability of such processes to compel full disclosure of financial and other information from regulated interests.

It is generally accepted that the so-called "information differential" between the regulator and the regulated interests is a major obstacle in the path of imposing a fair and equitable regulatory regime. The researching of this thesis has involved the reading of many American books and articles on the regulatory process, probably several hundred in number, as well as discussions with a number of American regulatory officials and lawyers. One significant common theme which has emerged from these

109. Prior to the recent General Election, other Labour Party spokespersons were somewhat more reticent in relation to the future of the privatised utilities under a Labour government. Dr Jack Cunningham MP, who had pledged to renationalise the water industry during parliamentary debates on the passing of the Water Bill 1989 was some six years later endorsing the retention of the industry in its privatised state. See speech by Dr Jack Cunningham MP, "Regulating the Utilities: Equity and Efficiency" (IPPR Conference on Regulation of the Utilities, 16 May 1995), noted in (1995) 6 Water Law 88-89.

110. See Hain, supra note 104 at p 21: "Furthermore, nobody is really suggesting a wholesale return to models of Morrisonian nationalisation which were highly centralised and bureaucratic, discouraging investment, managerial initiative, worker participation and consumer responsiveness." The new approach of the Labour government is becoming apparent through initiatives such as the review of utility regulation launched by the Trade and Industry secretary on 30 June 1997. See article in the Financial Times, 1 July 1997: "Re-regulating the utilities."
discussions has been widespread scepticism as to the ability of industry regulators in
the United Kingdom to obtain adequate financial and other information from regulated
interests in the absence of structured procedures expressly designed to ensure such an
outcome.

(ii) The US Approach

It would be easy enough to accuse US regulatory lawyers, with their preference for
trial-type procedures, of being motivated primarily by self-interest. However, while
such criticisms might not be totally unjustified, quite genuine reservations, and in some
cases a degree of incredulity, were expressed to me by US commentators that the UK
system could function adequately in practice. A view commonly held was that a
regulator with limited powers of compulsion could never guarantee that large and
sophisticated companies with access to the best quality advice, whether of a legal,
economic or accounting nature, were in fact providing the regulator with the full story
or only with a story which appeared to be plausible on its face.

The US system of economic regulation has sought to avoid such difficulties by using a
variety of procedures. As was noted in chapter 6, these range from formal “on the
record” rule making hearings, which are used in rate setting matters for example, to less
formal “notice and comment” rule making where intensive external scrutiny and active
participation by intervenors assist in bringing about the same result. In the case of
formal hearings, the usual adversarial procedures of discovery, inspection, summoning
of witnesses and cross examination at trial are combined to ensure that all relevant
information is available as part of the hearing process and that its accuracy can be
tested.

Even in the case of less formal rule making procedures, the ability of intervenors to
participate through making submissions and examining the agency record is a
significant advantage, as commentators such as Stelzer have noted. 111 This is

111. Stelzer, "Regulatory Methods: A case for 'Hands Across the Atlantic'" in Veljanovski (ed),
one in which all interested parties should be permitted - nay, encouraged, even paid - to
participate. Views are solicited from lawyers and experts representing the regulated firms,
customers, competitors and potential competitors, local political bodies, consumer
especially the case with the regulation of public utilities, where the US state public utility commissions exist alongside complementary consumer protection bodies in which paid state advocates with considerable expertise in regulatory procedures are able to play an active role in the regulatory process. These aspects will be examined in greater detail in chapter 10.

The balance to be struck between pursuing democratic ends at all costs and achieving reasonable expedition and efficiency in the regulatory process is of course a difficult one. This writer's own view is that in general terms the US regulatory process errs too far towards the democratic end of the spectrum whereas, again in general terms, the UK process sometimes errs too far in the direction of expedition (if not expediency).

The goals of democratic government are of course not necessarily synonymous with either efficiency or expedition, as Craig reminds us. Justice Brandeis, sitting on the US Supreme Court, once expressed a similar view in relation to the division of governmental powers under the US Constitution. The history of Europe in the present century has forcefully demonstrated the cogency of such concerns. While it may be desirable always to have the trains run on time, the cost of achieving such efficiency may prove to be unacceptably high.

(iii) Information Problems in Economic Regulation

It might be said of course that regulated interests will see it as their civic or corporate responsibility to participate in an open and unbiased way in the regulatory process,

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representatives (often self-appointed) and environmentalists and other special-interest groups. Nothing seems to please a regulatory body more than appending a massive list of intervenors to each decision. The parties are all accorded due process: they file motions, they participate in hearings, they file briefs, and - in the end - some of them appeal the decision to and through the courts. To the quite proper charge that this process produces huge costs, inefficiencies and delays, its proponents respond: 'True. But these are worth bearing in a democratic society.'

112. Craig, supra note 5, p 261: "If all decisions were made by an autocrat they would doubtless be made more speedily. A cost of democracy is precisely the cost of involving more people."

113. See Myers v United States 272 US 52, 293 (1926) per Justice Brandeis, in a powerful dissent: "The doctrine of the separation of powers was adopted by the Convention of 1787, not to promote efficiency but to preclude the exercise of arbitrary power. The purpose was, not to avoid friction but, by means of the inevitable friction incident to the distribution of the governmental powers among three departments, to save the people from autocracy."
without resort to the machinations of creative accountants, or without heeding the demands of shareholders for profit maximisation. Those who have a less optimistic view of the corporate world (or perhaps greater commercial experience of it) may incline to take the view that regulated entities will make use of every available device to minimise the impact on them of the regulatory process. Indeed, the moral arguments here are not unlike those which arise in the area of tax avoidance. One school of thought contends that all tax avoidance devices, which ultimately serve to distort the tax burden in favour of the wealthy and the well-advised, are essentially immoral and should not be permitted. The other school of thought, (which in the past has attracted periodic judicial support\textsuperscript{114}), maintains that all taxpayers are entitled to order their financial affairs, within the law, so as to minimise the incidence of taxation.

The theoretical ways in which monopolists can take advantage of their favourable economic position have been well documented.\textsuperscript{115} The allocation of costs among various subsidiaries, with the accompanying temptation to load costs onto the entity which is to be subjected to the attentions of a prospective market entrant, is one approach which has not been unknown in practice. In the telecommunications field, BT's competitors have complained, for example, that the costing of interconnection charges by BT allegedly includes allowances for items such as advertising and promotional expenses. Such costs are of course expended with the object of preserving BT's own market share in the face of increasing competition!\textsuperscript{116} An approach of this kind, which effectively requires competitors to pay for the supposed privilege of

\begin{itemize}
  \item \textsuperscript{114} Perhaps the best known example, much quoted by tax practitioners, is the dictum of Lord Tomlin in the House of Lords in \textit{IRC v Duke of Westminster} [1936] AC 1 at 19-20: "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax." The House of Lords has more recently shown an inclination (somewhat less endearing to tax practitioners) towards interpreting tax statutes purposively and in favour of the Revenue. See for example article by Elman, "Easy Cases Make Bad Law" \textit{The Tax Journal}, 30 June 1997, p 4, discussing the recent McGuckian case.
  \item \textsuperscript{116} Views expressed by Dr Monserrat, Operations Manager of Scottish Telecom, at the OFTEL public hearing on Thursday, 23 November 1995 and by Mr Paul Chisholm, Chief Executive Officer of Colt Telecommunications, in an interview with the writer on 5 December 1995.
\end{itemize}
competing against the incumbent monopolist, is inherently anti-competitive. Similarly
the possibility of a privatised utility inflating management and operating expenses may
lead to pricing formulas being unduly generous. The ability of Northern Electricity to
accumulate a £560m "war chest", which was available to fund defensive measures
against a hostile takeover bid in early 1995, provides a recent illustration that such
difficulties are far from being purely hypothetical in nature.117

In the context of utilities regulation, the industry regulators have clearly been concerned
to obtain sufficient information from the regulated companies to be able to assess the
adequacy of the pricing formulae and the efficiency of operation of the regulated
companies. In the water industry, OFWAT has gone into considerable detail on the
information which it wishes to see the water companies provide to the Director General
of Water Supply.118 In the case of gas, OFGAS has been similarly concerned to ensure
that the costings of British Gas are fairly distributed among its production, distribution
and administration operations, and this concern has been evident in a number of its
published consultation documents and reports.119 Interviews with OFGAS personnel
over the latter part of 1995 in the course of researching this thesis indicated that the
possibility of British Gas allocating a disproportionate cost burden onto its distribution
arm, TransCo, were a current area of concern at that time.120

In the case of telecommunications, OFTEL has been similarly concerned to ensure that
it has sufficient information to make an accurate assessment of BT's cost allocations
among its various operating divisions. This culminated in OFTEL's decision that with

117. See the discussion of this situation in part 7.4.6(iii) of chapter 7.
119. See for example the following OFGAS publications: A Pricing Structure for Gas Transportation and Storage (December 1993); Pricing Transportation and Storage (June 1994); Proposed Price Control on Transportation and Storage (June 1994); Price Controls on Gas Transportation and Storage: The Director General's Decisions (August 1994); Pricing Methodology for Gas Transportation and Storage (October 1994); Separation of British Gas' Transportation and Storage Business from its Trading Businesses (October 1994); Separation of British Gas' Transportation and Storage Business from its Trading Businesses: The Director General's Decision (February 1995); Price Control Review: British Gas' Transportation and Storage (June 1995); Network Code: Liabilities Payable by British Gas TransCo (July 1995).
120. Interview with Mr Kyran Hanks, Economic Advisor, Regulation and Business Affairs, OFGAS, 15 November 1995.
effect from the 1994 financial year BT must begin furnishing separate accounts for each operating division. In relation to rail transport, the Rail Regulator and the Director of Passenger Rail Franchising have been given extensive legislative powers to require the provision of information from licensed rail service operators. Detailed conditions requiring licensees to provide the regulator with adequate information have been inserted in rail operators' licences.

The regulators are therefore not lacking the theoretical power to compel the provision of information. How they can satisfy themselves as to the adequacy or accuracy of the information which is provided is another issue, which will be dealt with further below.

(iv) Two Possible Areas of Difficulty

Two other areas of difficulty in relation to provision of information are worth mentioning at this point. The first is the treatment of information which the regulated interests consider to be commercially sensitive. The statutory powers of the various utility industry regulators allow only limited powers of disclosure by the regulators, on the basis that disclosure must either benefit customers or must be made in the pursuance of the regulatory function.

More recently, the industry regulators have expressed a preference for receiving submissions in a form which can be made publicly available to interested parties. Recent consultation papers issued by OFGAS, for example, have addressed this issue directly. TransCo apparently indicated to OFGAS during 1995 that it considered


122. See for example Railways Act 1993, s 9(3)(f).


124. See for example the OFGAS consultation document, Price Control Review. Supply at or Below 2,500 therms a Year. British Gas Supply. A Consultation Document (November 1995), p 5; "We intend to place the replies to this consultation in our library. It is open to respondents to mark all or part of their responses as confidential. However, we would prefer, as far as possible, that responses are provided in a form that can be placed in Ofgas' library."
that up to 20% of the financial information TransCo had provided to the regulator for the purposes of consultation on the Network Code was commercially confidential, although this view was treated with some degree of scepticism by OFGAS.125

In the case of US rate setting procedures the scope for claiming commercial confidentiality in respect of regulatory information is much more limited. In the context of US regulatory hearings, exhibits containing financial and other details inevitably form part of the publicly available hearing transcript and can be obtained through the processes of pre-hearing discovery in any event. The presumption in US regulatory practice is against confidentiality. The burden of overturning this presumption lies heavily on the party seeking to raise confidentiality arguments to support an objection to the disclosure of information, as the US case studies in chapter 10 will illustrate.126

Another objection which has been made from time to time by regulated interests has been based on the perception that regulatory demands for information have been oppressive or have exceeded what is reasonably necessary for the carrying out of the regulatory function.127 As Veljanovski has noted much of this regulatory information would need to be produced by competitive firms for their internal purposes in any event and disclosure of extensive financial and other information is the *quid pro quo* which a utility in a natural monopoly position has to accept in exchange for its privileged economic status.128

Despite the considerable efforts being directed by industry regulators to the obtaining of adequate information from the regulated industries, the suspicion remains, at least for

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125. Interview with Mr Kyran Hanks of OFGAS, *supra* note 120. For further discussion of this subject see Baxter, "Public Access to Business Information Held by Government" [1997] JBL 199.

126. Information supplied during an interview on 27 December 1995 with Mr Robert R Bruce, partner with the London office of the major US law firm Debevoise & Plimpton and former General Counsel to the FCC in Washington DC during the 1980s. The US APA, §556, provides for all testimony and exhibits to be incorporated into the record in agency adjudication proceedings. See also the discussion in part 10.5 of chapter 10.


128. For a discussion of this point see Veljanovski, *supra* note 123, p 65.
this writer, that these procedures may not prove to be adequate in all cases. In the end the process is devoid of any form of scrutiny through a public hearing or inquiry and its attendant procedural compulsions, and this may result in the regulator being told what the companies want him or her to hear. Demonstrating such a proposition at the empirical level might well be an extremely difficult, if not impossible, thing for an inquisitive outsider to achieve but the example of Northern Electricity referred to above is a compelling one. After all, £560m is a lot of extra money, in anyone’s language, for a utility company somewhat fortuitously to discover that it has available to ward off troublesome corporate marauders.

8.3.3 APA-Type Procedures and Third Party Participation

There are two other possible advantages in the use of APA-type procedures which are worth canvassing here. The first of these is the opportunity which such procedures afford for participation by interested third parties. It can of course be argued that the consultation procedures which are increasingly being pursued by the various industry regulators allow such groups an adequate opportunity to present their views as part of the consultation process. However a more structured procedure has certain perceptible advantages.

To begin with, it is more difficult for a regulatory body which is required either to conduct a public hearing or provide a detailed record supporting why it has pursued a particular line, to disregard or ignore third party submissions without expressly addressing them. The US system at least has the advantage that all points of view, both rational and irrational, have to be met head on by the regulatory authority, as Stelzer has pointed out. 129

129. Stelzer, supra note 111, pp 61-62: "Remember: but for the work of environmental intervenors in the famous Madison Gas & Electric case, the adoption of more efficient pricing of electricity would have been delayed for many years. If academics had not meddled in the legislative process, airline deregulation would have been longer in coming. And if conservationists - many of them strident and some plain daft - had not intruded into the electricity scene, we would not now be groping for better ways to compare the costs of adding supplies with those of reducing demand."
All of this of course begs the question of whether or not adequate mechanisms exist to enable third parties to play a meaningful part in the regulatory process. There is little point in suggesting that a neighbourhood environmental group consisting of 10, or even 100, members should take on the cost and expense of participating in an MMC review or a judicial review proceeding without the assistance of any public funding or external support. In the United States such problems of representation have been addressed through providing state funded consumer advocates to participate in regulatory hearings. This system, which appears to function reasonably well in practice, will be the subject of further discussion in chapter 10. Just as there is little point in owning a motor vehicle, but not being able to afford the fuel to operate it, so there is little point in giving a local consumer group the opportunity to take on industry leaders such as BT or British Gas solely on the basis of its own resources. Structured participation procedures, in isolation, are therefore only one element in an improved regulatory regime.

Funding is not the only issue affecting third parties. The availability of a regulatory regime which provides finality and solutions to regulatory problems within a defined time frame is also important. In other words, while efficiency is not the sole objective of a regulatory regime, a certain level of efficiency is indispensable. A persistent criticism of the present system of economic regulation in the United Kingdom, which will be addressed in more detail in the following chapter, is that finality and the resolution of issues within a reasonable time frame often prove to be elusive goals. The existing process of consultation and discussion can prove to be too open-ended and can work in favour of a party that wishes, for its own reasons, either to drag the chain or to be deliberately obstructive. It is perhaps no coincidence that the latter forms of behaviour often seem to be most in evidence where incumbent monopolists are concerned. Delay favours the incumbent in a monopoly situation. Every extra day in which monopoly profits can be earned operates in favour of the party which is earning them and against a prospective market entrant which is struggling to get established. It is therefore unsurprising that parties in such a position will be reluctant to abandon their economic advantage and will seek to postpone this outcome for as long as possible.

While the American system of public hearings and trial-type procedures can be the subject of justifiable criticism in many areas, such procedures do have the advantage of
promoting finality and the resolution of regulatory issues. Just as Dr Johnson remarked upon the fact that pending execution concentrates the victim's mind wonderfully,\textsuperscript{130} so a pending regulatory hearing has the same effect in terms of the resolution of regulatory disputes. The imposition of a deadline either serves to promote a negotiated settlement or leads to the adjudication of the dispute by a third party within a set time frame.

8.3.4 The Role of Judicial Review

(i) Introduction

The second aspect which is of significance is the availability of judicial review as a supervisory mechanism. Chapter 6 described in some detail the way in which judicial review functions as a constraint on the US regulatory process. (Indeed a respectable body of opinion maintains that it constitutes too great a restraint.)

In considering the extent to which the remedy of judicial review applies to the decisions of economic regulators in the United Kingdom, some consideration needs to be given to the kinds of bodies which are amenable to judicial review and the way in which the remedy functions in practice. After first considering these aspects, this part of the chapter moves on to examine the approaches to judicial review adopted in the United States and the United Kingdom and seeks to identify areas of difference between the two jurisdictions in this area. This discussion will also be particularly concerned with the issue of the appropriate degree of judicial deference to the decisions of regulatory agencies and the extent to which the concept of reviewability for mistake of fact has developed in each jurisdiction.

(ii) The Issue of Jurisdiction

To begin with the issue of the types of entity that are susceptible to judicial review, the traditional approach in the United Kingdom was to consider the nature of the body in

\textsuperscript{130} "Depend upon it, Sir, when a man knows he is to be hanged in a fortnight, it concentrates his mind wonderfully." (Letter from Samuel Johnson to Boswell, 19 September 1777, from \textit{The Oxford Dictionary of Quotations} (Oxford University Press, 2nd ed, 1953), p 273.)
question and the derivation of its powers. This was an inquiry which generally focused on the type of powers being exercised, and in particular whether they were statutory in nature or were derived from the royal prerogative. In such cases judicial review was generally available. In the case of powers arising out of private law relationships, such as contracts or other forms of consensual relationship, the remedy of judicial review was generally not granted. The modern approach which the United Kingdom courts have adopted in this area is summarised in the 5th edition of de Smith, and focuses on the kind of function which is under scrutiny.

Chapter 2 examined the evolution of the concept of the public utility from its original theoretical basis, which was grounded in the performance of services of a public nature and in the public interest. That chapter considered how this concept has proved to be remarkably durable, despite the modern trend towards the privatisation of public utility services. As a matter of principle there seems to be no good reason why the determinations of such bodies, even in their privatised form, should not be amenable to judicial review, a view which is shared by both academic writers and the courts.


132. See de Smith, Woolf & Jowell, supra note 28, paras 3-023 to 3-024, pp 167-168: "Today, the courts recognise such an approach is too restrictive and they are now influenced by the type of function performed by the decision-maker whose action is challenged. Where a body is carrying out a public function (such as that undertaken by a non-government regulatory organisation in relation to the area of activity which is subject to its control), the courts will consider intervening to require compliance with the principles of judicial review. This is the case even if the body is non-statutory, exercising powers which are not derived either from legislation or the prerogative. A body is performing a 'public function' when it seeks to achieve some collective benefit for the public or a section of the public and is accepted by the public or that section of the public as having authority to do so. Bodies therefore exercise public functions when they intervene or participate in social or economic affairs in the public interest." [Footnotes omitted]

133. See de Smith, Woolf & Jowell, supra note 28, paras 3-027, 3-031, 3-047 and 3-051. The authors express the view at para 3-027 that one of the tests for the existence of a public function, and hence the availability of judicial review, is whether the government has "woven the body into the fabric of public regulation" or whether the body was established "under the authority of government." See also Lidbetter, "Judicial Review in the Company and Commercial Context" [1995] Butterworths J of Int Banking & Financial Law 62, and, in the New Zealand context, Chen, "Judicial review of state-owned enterprises at the crossroads" (1994) 24 VUWLR 51. For the Canadian position see Lucas, "Judicial Review of Crown Corporations" (1987) 25 Alberta
8.3.5 Judicial Review of Regulatory Decisions

(i) Telecommunications

At the time of writing there have been relatively few judicial review proceedings involving either economic regulators or regulated entities in the UK, though there are indications that this situation may be likely to change. The Director-General of Telecommunications has been the subject of proceedings brought against him by Mercury Communications Ltd in respect of the interpretation of a condition of the BT telecommunications licence. However, these proceedings were brought by way of originating summons seeking a declaration confirming that Mercury's contention as to the proper construction of a provision of the BT licence was correct.

The matter eventually came before the House of Lords on an application to strike out the summons on procedural grounds. The respondents argued that the matters raised were public law issues and should only be raised by way of the judicial review procedure. In the House of Lords, Lord Slynn of Hadley noted in his judgment that the dispute essentially concerned the interpretation of the licence conditions in question and the applicant was not obliged to follow the Order 53 procedure and seek judicial review. 134

LR 363. More general discussions of this area can be found in Sinclair, "Judicial Review of the Exercise of Public Power" [1993] Denning LJ 193 and in the essays in Taggart (ed), The Province of Administrative Law (Hart Publishing, Oxford, 1997). For some examples of cases where judicial review has been sought in respect of regulatory bodies in the economic area, see Laker Airways Ltd v Department of Trade [1977] 2 All ER 182; R v Panel on Takeovers and Mergers, ex p Datafin plc [1987] 1 QB 815; R v Panel on Takeovers and Mergers, ex parte Guinness plc [1990] 1 QB 146; R v Independent Television Commission, ex parte TSW Broadcasting Ltd (House of Lords, 26 March 1992, LEXIS); R v British Coal Corporation and the Secretary of State for Trade, ex parte Vardy [1993] IRLR 104 (noted in Villiers and White, "Judicial review of the colliery closures" (1994) 5 Util LR 39); R v LAUTRO, ex parte Ross [1993] QB 17; R v SIB, ex parte Sun Alliance Society plc (The Times, 9 October 1995).

134. Mercury Communications Ltd v The Director-General of Telecommunications and others (House of Lords, 9 February 1995, LEXIS) at page 8: "Moreover it cannot be said here, in my view, that the procedures under Ord 53 are so peculiarly suited to this dispute (as they would be in a claim to set aside subordinate legislation or to prohibit a Government department from acting) that it would be a misuse of the court's process to allow the originating summons to continue. On the contrary it seems to me that the procedure by way of originating summons in the Commercial Court is as least as well, and may be better, suited to the determination of these issues than the procedure by way of judicial review." For further recent discussion of the issue of when the judicial review procedure should be utilised in preference to an ordinary action see Trustees of the Dennis Rye Pension Fund and Anor v Sheffield City Council (Court of Appeal, 31 July 1997, LEXIS), in which Lord Woolf MR placed emphasis on the practical consequences
There is however nothing in his Lordship's judgment to suggest that, as a general principle, judicial review is not available against the Director-General of Telecommunications in a suitable case, even though the declaration procedure may be more suitable for a proceeding aimed at obtaining an interpretation of a contractual licence condition. Indeed Lord Slynn of Hadley recognised that the Director-General was performing public duties in seeking to secure the provision of reasonable telecommunications services in the United Kingdom under the Telecommunications Act 1984.135

(ii) Broadcasting

(a) The TSW Broadcasting Case

In the field of broadcasting, the functions formerly carried on by the Independent Broadcasting Authority (IBA), prior to the industry restructuring effected by the Broadcasting Act 1990, have now been assumed by the Independent Television Commission (ITC) and the Radio Authority.136 The IBA regime had earlier been the subject of criticism by Lewis and others, especially in relation to the procedure adopted for the award of programme contracts. Professor Lewis was particularly critical of the lack of full public hearings for the award of franchises and the lack of reasoned decisions on the part of the authority in all cases.137

of the choice of procedure to the parties, the public and the court, rather than technical distinctions between public and private rights.

135. See the discussion of this point at page 8, paragraph 1 of the LEXIS transcript of the judgment.


137. Lewis, ibid, p 339: "The view tentatively adopted is that the Authority has gone nothing like far enough to satisfy the canons of open government in other directions either though in this respect it is no worse than, and often a great deal better than, many other public institutions. The argument about openness is, in all likelihood, a seamless web with questions surrounding open hearings, the giving of reasons for decisions, the publishing of and public involvement in standard-setting and consultation over major policy decisions all being inextricably linked." For a discussion of the reviewability of IBA decisions see Graham and Prosser, supra note 25, pp 55 - 56.
Extensive changes were made under the 1990 Act in relation to the award of radio and television licences. Quality requirements were set out in some detail in the new legislation.\(^{138}\) In relation to the award of the Channel 3 television licence, the Commission was required to award the licence to the highest cash bidder.\(^{139}\) However this requirement could be disregarded and the licence awarded to another applicant if it appeared to the Commission that there were "exceptional circumstances which make it appropriate for them to award the licence to that applicant."\(^{140}\)

The circumstances surrounding the award of the Channel 3 franchise gave rise to an application for judicial review. TSW Broadcasting Limited had applied for the ten-year Channel 3 franchise, to commence from 1 January 1993, and had submitted a bid of £16.117m per annum. On 16 October 1991 the ITC rejected TSW's application and granted an application by Westcountry Television, which had submitted a substantially lower bid of £7.815m per annum. In rejecting TSW's application the ITC had formed the view under s 16(1)(b) of the 1990 Act that TSW would be unable to maintain the required standards of service throughout the whole of the licence period.

On 13 November 1991 TSW applied to the High Court for judicial review of the ITC's decision. TSW argued first that it had satisfied the criteria under s 16 for the award of the licence and that the ITC had therefore acted irrationally in not deciding in its favour. Alternatively TSW argued that the Commission had taken into account other criteria not spelled out in the invitation document and that this involved either unfairness or a breach of TSW's legitimate expectation that the Commission would not act in this way.

In refusing leave to proceed with the judicial review application Simon Brown J held, at first instance, that both proposed grounds of challenge were "doomed to inevitable failure."\(^{141}\) The judge reached this conclusion on the basis that there was no representation made that the ITC would restrict itself to the terms of the invitation

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138. See for example the detailed criteria in s 16(2).
139. Section 17(1).
140. Section 17(3).
document in reaching its decision. Similarly the judge was not persuaded that certain research material relating to Westcountry’s proposals, even if published in time for public representations to have been made on it, would have affected the outcome of Westcountry’s application.

TSW then sought leave to proceed in the Court of Appeal, which granted leave on 5 December 1990 and subsequently went on to hear the application, judgment being given on 5 February 1992. The Court of Appeal dealt in detail with both the legal and factual issues, including the licensing procedure under the 1990 Act. Lord Donaldson MR noted that there was a “public interest in ensuring that the prescribed method of allocating licences be followed, whatever criticisms may be made of that method.” He considered in detail the sources relied upon by the Commission in reaching its decision. While in his Lordship’s view the ITC’s consideration of the applications could not entirely escape criticism, overall the ITC was entitled to reach the conclusion which it did on TSW’s inability to meet the sustainability requirement.

In relation to the secondary complaint by TSW alleging unfairness on the part of the Commission, his Lordship thought there was more validity to this contention and that the ITC had not correctly applied the statutory test in s 16 of the Act. He would have allowed the appeal for this reason. However, the two other judges in the Court of Appeal took the view that on the totality of the evidence the ITC was justified in reaching the conclusion which it did and held that its decision should not be quashed.

From this decision TSW appealed to the House of Lords, the appeal being heard on an urgent basis during February 1992. In the House of Lords, Lord Templeman observed in his judgment that the preferable course for the ITC would have been for it to have given reasons in writing for its original decision, so that there was no doubt as


143. *Ibid* p 11.


to the basis on which the decision had been reached.\textsuperscript{146} However this omission did not of itself invalidate the decision.\textsuperscript{147}

Lord Templeman went on to criticise the views expressed by the Master of the Rolls in the Court of Appeal, noting that these had been based on an erroneous approach to the documents in question, and only served "to demonstrate the danger of a judge contradicting a conscientious decision maker acting in good faith with knowledge of all the facts."\textsuperscript{148} Lord Goff of Chieveley took a similar view in his judgment, observing that the argument advanced by TSW amounted to an attack upon internal staff papers presented to the Commission rather than to the Commission’s procedure itself. The other three Law Lords concurred in these judgments and TSW’s appeal was dismissed in what was a significant decision in this field.\textsuperscript{149}

The case is also of interest as an illustration of the appropriate degree of judicial deference to a specialised regulatory tribunal. As Lord Templeman observed in the passage quoted above, a judge on review who has not had the benefit of hearing the whole of the evidence supporting the decision reached by the regulatory body, can often be led into error or blinded by a mass of detail, as had occurred in the case of the Master of the Rolls in the Court of Appeal. Having decided that the Commission had not acted irrationally or unfairly in reaching its decision the House of Lords declined to interfere in the decision making process.

\textsuperscript{146}. \textit{Ibid} p 6 of LEXIS transcript.

\textsuperscript{147}. \textit{Ibid} p 9: "But the rules of natural justice do not render a decision invalid because the decision maker or his advisers makes a mistake of fact or a mistake of law. Only if the reasons given by the ITC for the decision to reject the application of TSW disclosed illegality, irrationality or procedural impropriety, then, in accordance with the speech of Lord Diplock in \textit{Council of Civil Service Unions v The Minister of Civil Service} [1985] AC 374 at p 410, and the judgment of Lord Greene MR in \textit{Associated Provincial Picturehouses Limited v Wednesbury Corporation} [1948] 1 KB 223, could the decision be open to judicial review. This is not a case in which TSW can rely on any breach of the principle of proportionality or can require a close scrutiny of possible threats to human rights or fundamental freedoms."

\textsuperscript{148}. \textit{Ibid} p 13.

\textsuperscript{149}. Prosser, \textit{supra} note 145, p 49: "Nevertheless, the case is of considerable importance in exposing to detailed scrutiny the procedures and decision making criteria of the regulatory authority allocating broadcasting licences. It is also welcome to see a clear judicial statement that the Commission is subject to the rules of natural justice, though, apart from invalidating decisions actuated by bias, it is unclear what the content of the rules would be in this context; certainly no oral hearing was required, and none given prior to the decision."
(b) The Channel 5 Television Licence

The increasing popularity of judicial review as a means of challenging decisions by regulatory bodies such as the ITC has again recently been illustrated by Virgin Television's judicial review application in late 1995 in relation to the ITC's award of the Channel 5 television licence to Channel 5 Broadcasting Limited.\textsuperscript{150} This case involved the Channel 5 franchise, where four bidders had applied for the licence. The successful bidder was Channel 5 Broadcasting, a consortium made up of several media interests, which had submitted exactly the same figure as Virgin Television (£22,002,000). The licence was awarded to Channel 5 Broadcasting on 27 October 1995 with a projected launch date of 1 January 1997.\textsuperscript{151}

Of the four bidders, Virgin Television and UKTV, which was the highest bidder, failed to pass the programme quality threshold. This threshold was passed by the successful bidder and also by one other bidder, New Century Television. In its application for leave to bring judicial review proceedings Virgin Television alleged that the ITC decision was wrong or irrational in a number of respects. These included the fact that Virgin Television allegedly had better programme content than New Century Television (one of the two bidders which had passed the quality threshold), that it had more programme staff than the other applicants and that the ITC had not followed the recommendations of its staff that all four bidders should be eligible for consideration for the award of the licence. Virgin Television also alleged that the ITC breached its

\textsuperscript{150} R v Independent Television Commission, ex parte Virgin Television (Queen's Bench Division, Judge J, 22 November 1995.)

\textsuperscript{151} I am grateful to Sarah Thane, ITC Controller of Public Affairs, for providing me with a good deal of useful information, both on the award of the Channel 5 licence and on ITC procedures generally, in the course of an interview with me on 22 November 1995. For background material on the issue of the Channel 5 licence see Consultation on the Future of Channel 5 (ITC Consultation Document, July 1993), issued after an unsuccessful initial attempt to grant the licence in December 1992, only one applicant having expressed interest at that time; "ITC Announces its Decision to Award Channel 5 Licence" (ITC Press Release 78/95, 27 October 1995). The relevant statutory provisions can be found in the Broadcasting Act 1990, ss 28-30. Following an expensive retuning campaign (costing some £90m more than the initially projected figure of £60m) Channel 5's commencement date was delayed to 30 March 1997. See article in The Times, 11 December 1996: "Interference has almost cleared."
own rules by wrongly permitting the successful applicant to improve aspects of its bid after the closing date for applications had passed.152

At the substantive hearing the Divisional Court, consisting of Lord Justice Henry and Mr Justice Turner, began by considering the statutory scheme prescribed by the Broadcasting Act 1990.153 The Court considered that, as well as the applicant, Virgin Television Limited, another unsuccessful applicant, New Century Television Limited, should also be permitted to be heard on the judicial review application as New Century had a similar interest in the outcome of the court proceedings to that of Virgin Television and that it was not appropriate to take a narrow view of standing requirements in such circumstances.154

The Court went on to consider the statutory scheme of the 1990 Act in the light of the *TSW Broadcasting Limited* decision.155 It noted that the Commission was obliged to act fairly as between competing applicants, that the Commission alone had the particular task of setting and assessing the attainment of quality thresholds by applicants, that there was no statutory right of appeal from the Commission's decision

152. For a discussion of the award of the Channel 5 licence and the basis for Virgin Television's judicial review application see article in the *Financial Times* of November 23, 1995: "Virgin wins judicial review of channel 5 award" and article in *The Lawyer*, 5 December 1995: "Broadcasting decision set for challenge".

153. See *R v Independent Television Commission & Anor ex parte Virgin Television Limited* (Divisional Court, 24 January 1996, Henry LJ and Turner J). I am grateful to my thesis supervisor Professor Jeffrey Jowell QC for arranging to obtain a copy of this unreported judgment for me from counsel for the ITC in the case.

154. The Court noted in its judgment, *ibid*, p 4 that: "We were of clear opinion that both parties [i.e. Virgin Television and New Century Television] should be heard. The Court has ample powers to disallow purely repetitious argument, and while the issue may be the same, it does not follow that the arguments developed to support it necessarily will be. It seemed to us that both of these parties were persons directly affected, and accordingly we gave leave for them to be heard. In the event their submissions were not mere duplication, indeed one submission raised by Sir Patrick Neill on behalf of New Century resulted in the applicants amending their Form 86A in order to incorporate it. We have resisted any temptation to say anything of more general import on the question of locus standi in judicial review. But, judicial review being often concerned with the identification of a public wrong, the conventional adversarial approach may often be too narrow."

155. *Supra* note 145.
and that s.15(4) of the 1990 Act empowered the Commission to require an applicant to provide subsequent additional information after its application had been submitted.\^\textsuperscript{156\,} The Court considered the various heads of challenge in turn. The first ground was that the Commission should have rejected the successful applicants' bid as not being in compliance with the terms of tender. On this point the Court considered that on the basis of all the factual circumstances the Commission was entitled to take the view that the successful applicant would have access to adequate funding by the date of grant of the licence.\^\textsuperscript{157\,} The next ground of challenge was whether the ITC was entitled to have regard to an additional amount of funding to be provided after execution of the consortium shareholders agreement entered into by the successful parties on 15 September 1995. The Court again considered the factual background in some detail and considered that the Commission was entitled to act on the basis of additional financial information or commitment provided after the date of the application, bearing in mind the provisions of s.15(4) of the 1990 Act. In the Court's view there was no unfairness in the procedure which the Commission had adopted in the particular circumstances. Although the successful applicant gained an advantage from the operation of the process, it was not an unfair advantage in terms of the statutory scheme.\^\textsuperscript{158\,}

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\item \textsuperscript{156.} See the discussion in the judgment, \textit{supra} note 153, at pp 7-8.
\item \textsuperscript{157.} See p 18 of the judgment, \textit{supra} note 153: "In our judgment this first point manifestly fails. There was no illegality in the Commission accepting as compliant the proposal containing the commitment in the form in which it was. Nor could it be argued (and it has not been argued before us) that it was irrational to treat that commitment as sufficient - as the fact that the consortium of shareholders entered into an agreement dated 15th September for an additional £100m makes clear. The Commission was clearly not wrong in their judgment either of the depth of their pockets or of their commitment."
\item \textsuperscript{158.} See judgment, \textit{supra} note 153, at pp 26-27: "Assuming the submission to be right, and assuming that there was some advantage to C5B, that does not mean that it was an unfair advantage. It simply means that the statutory scheme as amplified by the rules of tender worked out better for C5B than for the other bidders. There is nothing to suggest that C5B were allowed to have their shareholders' additional commitment taken into account because they were treated preferentially, but rather because the rules permitted, it. There is nothing to suggest that the other applicants would not have been similarly treated if they acted as C5B did. Indeed, it seems to us that, under the Rules, had C5B's supplementary shareholders' agreement not been recognised, they might have had legitimate cause of legal complaint."
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The applicant also challenged the Commission's decision on the grounds that it was irrational or perverse, arguing in considerable detail that the Commission had not given adequate consideration to relevant aspects of the competing applications. In relation to this ground of challenge, the Court considered that it should be on its guard not to act as a review body in terms of the facts themselves. In the Court's view, the ITC was the expert body entrusted by Parliament with the task of reaching a decision within its particular area of expertise and it was not for the Court readily to second-guess the Commission's decision.

Even if there were mistakes of fact in individual areas these might not necessarily invalidate the overall decision "provided that the mistakes are not grave enough to undermine the basis of a multi-faceted decision". In the present case the Court considered the specialised qualifications and experience of the individual Commission members and also devoted particular attention to the evidential material which the Commission had considered. The Court observed that, given the demonstrable care with which the Commission had approached its task, the Court should be slow to upset the decision which it had reached. In assessing the Commission's decision making...

159. See the judgment, supra note 153, at p 32: "In a schedule annexed to Form 86A, Virgin set out over some eleven pages the particular respects in which the Commission reached their decision and which had led to the Commission reaching a decision which was allegedly irrational. Examination of the constituent parts of the schedule is necessary if the court is to assess the validity of the assertion. But the court must be on its guard not to assume the mantle of the Commission itself (as the decision making body) and in particular to not allow itself to become a Court of Appeal from the decision making body when no such provision is made in the Act which created the Commission and vested it with clearly defined powers and duties."

160. See the judgment, supra note 153, at p 34: "Of its nature such an exercise [i.e. determining the facts on which the final decision would be based] is, as Mr Sumption [leading counsel for the ITC] submitted, judgmental in character and, therefore, one upon which opinions may readily differ. Especially is this so within this area of decision making where the exercise is not simply a quantitative exercise (per Mr Scrivener) but involves a qualitative analysis and judgment (per Mr Sumption). It has to follow that a very heavy burden falls on the party seeking to upset a qualitative judgment of the nature described and arrived at by the qualified and experienced body which is the Commission, as to which see below."

161. Ibid p 35.

162. Ibid p 40: "It is quite plain that the Commission approached its task of evaluating the application and the evidence provided by Virgin to support it with model care. There must accordingly be a natural, as well as a judicial, reluctance to conclude that the decision was flawed. This is not a consequence of judicial conservatism or intellectual disinclination. It is a logical consequence of the perceived care and meticulous approach which the Commission brought to bear on its task of assessment and evaluation in accordance with what Parliament has entrusted to it. It is also a consequence of the limits which the court is required to observe in determining whether or not the decision maker has arrived at a decision which has a sufficient factual basis."
process it was not appropriate to consider individual weaknesses in the decision (where these were not fatal to the overall validity of the determination) or to focus on particular factual aspects in isolation. Such an approach, in the context of a judicial review application, would inevitably lead to the Court straying outside its sphere of expertise.163 Accordingly the complaints of irrationality or Wednesbury unreasonableness were rejected. In the event the judicial review challenge to the ITC decision was dismissed. No appeal is being pursued by Virgin Television.

This judgment is significant in this area in that it illustrates that the English courts will be prepared to extend due deference to a decision by a regulator having particular qualifications and expertise in a specialised area. In the Channel 5 case, once the court hearing the judicial review application had satisfied itself on the affidavit evidence which had been adduced that the Commission did have the relevant specialist experience and had given detailed consideration to all aspects of the competing applications, it was prepared to defer to the Commission’s expertise in the broadcasting area.

While it may have been possible to criticise individual aspects of the ITC decision, there were adequate grounds, looking at the matter overall, to uphold the decision which had been reached. To this extent the court in the Channel 5 case adopted a remarkably similar approach to that taken by Lord Templeman in the House of Lords in the earlier TSW Broadcasting Limited case. The Channel 5 decision serves to illustrate that applicants for judicial review seeking to challenge regulatory decisions of expert bodies such as the ITC will have a high threshold to surmount and that the court will generally defer to a reasonable decision by an expert regulatory body in a specialised area such as television broadcasting.

Despite these observations, however, it may well be that the broadcasting industry and the licence allocation process will come to represent an emerging area for the use of judicial review proceedings. Given the value of television licences and their prominent

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163. Ibid p 43: "The argument which was submitted and intended to pre-empt the Commission involved a detailed analysis of proposed programme schedules of not only Virgin, but also those of CSB and New Century as well. An exercise which the court (by reason of its lack of qualifications and experience) is not only not competent to attempt, but also which it is
public profile this development has a certain air of inevitability and may well be repeated in the case of any future television licence allocations.

(iii) The Rail Industry

The rail transport industry has also witnessed several recent judicial review challenges as privatisation of the industry has proceeded apace. The Scottish courts entered into the fray in the first half of 1995 in relation to proposals by the British Railways Board to discontinue the through-sleeper service from Fort William in Scotland to London Euston.

The Board was obliged by s 37(1) of the Railways Act 1993 to give notice of permanent discontinuance of a service before putting closure procedures into effect. In the present case the Board did not give notice under s 37, but argued that such notice was not required as it was providing a substituted passenger service on the sections of line involved. These consisted of three non-sleeper services of a more localised nature. Counsel for the Board conceded that the substitute services were provided for the express purpose of allowing the Board to contend that a passenger service was being maintained on the sections of line concerned, so that the s 37 requirements did not apply to the situation.

The Highland Regional Council brought a petition for judicial review in the Scottish courts, arguing that the substitute services, which the Board further conceded were unlikely to benefit the travelling public, did not qualify as a “railway passenger service” in terms of the definition of that term in s 83 of the 1993 Act. The Outer House of the Court of Session agreed with the Council’s contentions. Lord Kirkwood observed that a substitute service had to be a genuine service intended for the carriage of passengers and that a late-night service of unproven need, which might well not carry any passengers at all, was not a service which fulfilled the statutory requirements. The court concluded that the proposed discontinuance of the service was unlawful.164

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The matter proceeded to the Inner House of the Court of Session, which gave judgment on 7 June 1995. The Lord President, Lord Hope, noted that the public had a right to be heard under s 37 of the 1993 Act in relation to the proposed discontinuance of a rail passenger service. He agreed with the court below that it was difficult to accept that Parliament intended that the s 37 procedure could be circumvented in this way by a device which had the sole purpose of obviating the closure procedures. Accordingly the Board's decision ought to be overturned on the ground of illegality. This decision provides welcome judicial recognition of the importance of following prescribed consultation provisions.

The actions of the Franchising Director in implementing the franchising of passenger rail services under the rail privatisation programme have also faced challenge in the courts. A pressure group campaigning against the standards of privatised rail passenger services, Save Our Railways (SOR), brought an application for judicial review in the High Court. SOR alleged that the Franchising Director was in breach of his statutory obligations by agreeing to set minimum levels of passenger service requirements for privatised rail operators at a level well below the existing BR timetable.

At first instance the matter came before Mr Justice Macpherson of Cluny, who dismissed the applications for judicial review in a judgment given on 8 December 1995. The judge referred to the guidelines issued by the Secretary of State for Transport in 1994 for the assistance of the Franchising Director. While noting that the Franchising Director had allowed the levels of service to be set at figures ranging from 10 to 50% less than under the BR timetable, the learned judge took the view that

165. *Highland Regional Council v British Railways Board* (Inner House of the Court of Session, Lords Hope, Allanbridge and Osborne, 7 June 1995).

166. For a discussion of the role of the Director of Passenger Rail Franchising see part 7.6.1(i) of chapter 7.

167. *R v Director of Passenger Rail Franchising, ex parte Save Our Railways and others* (Queen's Bench Division, Macpherson of Cluny J, 8 December 1995), noted in *The Times*, 12 December 1995. See also article in *The Times* of 9 December 1995: "Judge rejects legal action against rail privatisation"; article in the *Financial Times*, 9 December 1995: "Court dismisses move to block rail privatisation".

168. *Objectives, Instructions and Guidance for the Franchising Director* (Secretary of State for Transport, 22 March 1994).
the extent of reduction of existing services was a matter within the Franchising Director’s discretion and that the approach that he had adopted was not unreasonable.

The passenger service requirements, in the court’s view, were not timetables but minimum service levels made against a statutory background that required the Franchising Director to take into account the need for value for money and flexibility. As there was evidence that the Franchising Director had considered the instructions in making his decisions on service levels there was no clear abuse of power which would justify judicial review. The only requirement was that the Franchising Director should use the existing timetables as a starting point for his determinations.

Undaunted, SOR appealed to the Court of Appeal, where its arguments received a more sympathetic reception. Sir Thomas Bingham MR, delivering the judgment of the Court of Appeal, noted that paragraph 23 of the Secretary of State’s 1994 guidance document required that service specifications must be based on the existing BR timetable. The Court of Appeal accepted that the guidance document did not have statutory force and was not subordinate legislation, but merely had to be read in a “practical, down to earth way” as a communication from the Secretary of State for Transport to a responsible public official. While the use of the phrase “based on” in the guidance document did allow for some degree of flexibility, any changes made to the existing level of services had to be marginal rather than significant or substantial. The document was not a warrant for more than relatively minor change.

In the case of two of the proposed services the reductions were not sufficiently significant to justify the court in intervening and the application had been the subject of undue delay. However the other services had been reduced beyond acceptable levels and judicial review of the Franchising Director’s decisions in respect of those services was granted. Prospective rail operators have argued that it would be in their own best interests to run as many trains as possible under their franchises. However the suspicion remains that, at least in relation to unpopular or little used services, a


170. For a discussion of the Court of Appeal’s judgment see article in *The Times*, 16 December 1995: “Rail sell-offs ruled unlawful.”
minimum requirement would have been in danger of effectively becoming a minimum service.\textsuperscript{171}

Following the Court of Appeal's decision the Government attracted further criticism from the successful applicants for judicial review by announcing that the franchising contracts would proceed on schedule. Rather than risking a further appeal to the House of Lords, the Government moved to circumvent the court's ruling by issuing new instructions to the Franchising Director on minimum levels of service. These new instructions entitled the Franchising Director to take account of proposals by franchisees to provide services over and above minimum levels.\textsuperscript{172} The new guidelines continue to allow the Franchising Director to exercise his individual judgment in particular cases. They would not therefore appear to fall foul of the criticism which has succeeded in other recent litigation that they have dictated a final result to the recipient of the guidance in question and have therefore gone beyond the lawful scope of guidelines.\textsuperscript{173}

The litigation over the terms of rail privatisation is of interest for several reasons. First, it shows a willingness on the part of the higher courts to adopt a purposive approach to the interpretation of Government guidelines to regulatory officials such as the Director of Passenger Rail Franchising. The Court of Appeal implicitly disapproved of the rather literal approach adopted in the court below and, in quite a robust judgment, affirmed that privatised rail services were not a licence to cut existing levels of service to an unacceptable extent. The fact that the Government chose to sidestep the court's

\textsuperscript{171} See for example editorial in \textit{The Times}, 16 December 1995 "Not on schedule": "Despite guarantees on little-used lines and early and late services, anything less than legal insistence might fall prey to lobbying by hard-pressed franchise operators. On some services there has been a remarkable coincidence between the trains that potential operators want to scrap and those Mr Salmon said could be dropped."

\textsuperscript{172} See article in the \textit{Financial Times}, 19 December 1995: "Move to sidestep rail judgment".

\textsuperscript{173} Cf the criticism recently expressed by Jowitt J of the 1993 policy guidance issued by the Secretary of State to the Local Government Commission in relation to the adoption of unitary authorities in place of the existing two-tier structure of local government: \textit{R v Secretary of State for the Environment, ex parte Lancashire County Council; R v Secretary of State for the Environment, ex parte Derbyshire County Council} [1994] 4 All ER 165. The guidelines in question were held to be unlawful to the extent that they conveyed the intended result of Government policy as an end in itself, thereby undermining the statutory criteria in s 13 of the Local Government Act 1992.
ruling, rather than require the Franchising Director to reconsider the franchises already awarded, is no fault of the courts.

The litigation also illustrates that while the courts may not ultimately be able to deflect a determined government from pursuing a particular regulatory policy, they can nevertheless highlight aspects of that policy which have not lawfully been pursued. It may be that the final word on rail privatisation has not yet been spoken at the political level. The Court of Appeal's decision certainly provoked further debate on the issue, both on the part of privatised rail-sceptics in the ranks of the Conservative party, as well as from members of the then Labour opposition.174

8.3.6 The Grounds for Judicial Review

(i) Three Basic Grounds

In the United Kingdom, the accepted grounds for judicial review are succinctly summarised in the 5th edition of de Smith.175 The scope of these three principal bases for the remedy are a matter of considerable importance in the present context. It will be recalled from the discussion of the UK regulatory scene in chapter 7 that there are limited rights to require the Monopolies and Mergers Commission to review the decisions of certain economic regulators. In the case of telecommunications, for example, there is no general right of MMC review available in respect of a regulatory

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174. See article in the Independent on Sunday, 17 December 1995: "Further challenge to rail sale", warning of the possibility of a Tory backbench revolt and of renewed pressure from the Labour opposition in relation to the rail franchising process.

175. See de Smith, Woolf & Jowell, supra note 28, para 1-026: "As we shall see, English law now recognises three principal 'grounds' of judicial review, known as 'procedural propriety', 'rationality' and 'legality'. These grounds are not isolated requirements of a discrete area of law; they refer to and attempt to impose upon all decision-makers standards that are inherent in a democracy. Procedural propriety imposes fair decision-making procedures necessary to the degree of participation which democracy requires. Rationality seeks the accuracy of decisions and prohibits excessive burdens being imposed on individuals. The ground of legality involves the application both of the sovereignty of Parliament and the rule of law, by requiring Parliament's will to be respected and official action to be congruent with legislative purpose." As the authors point out, these were the terms employed by Lord Diplock in Council of Civil Service Unions v Minister for the Civil Service [1985] AC 374. See also Jowell and Lester, "Beyond Wednesbury: Substantive Principles of Administrative Law" [1987] Pub. Law 368.
decision. Review by the MMC can only occur where there is lack of agreement between the parties on a proposed licence condition.176

(ii) The Need for Reasoned Decisions?

The judicial review procedure does of course require a determination which is in a suitable form to be reviewed. This in turn generally requires a decision which is sufficiently explicitly reasoned so as to be amenable to review in the courts. The difficulties arising in UK administrative law in the absence of a general duty to give reasons for administrative decisions have been canvassed extensively elsewhere.177 It appears from recent decisions that the United Kingdom courts, while stopping short (though in some cases not very far short) of recognising a general duty to give reasons for administrative decisions, are willing to imply the existence of such a duty in certain circumstances. Such an implication may particularly arise where there is a statutory right of appeal from an administrative decision.178

In the case of regulatory decisions the absence of a requirement to give reasons, or indeed of any consistency of approach in this area, has been an aspect of UK economic regulation which has attracted widespread criticism from all points on the political spectrum. In his recent work on developing a stakeholder-based theory of regulation, based on the tenet that regulatory regimes should seek to balance the interests of conflicting stakeholder groups, Souter has focused on the need for justifying regulatory decisions, arguing that this is a basic requirement for achieving fairness in regulatory decision making.179

176. Telecommunications Act 1984, s 13(1).


179. Souter, "A Stakeholder Approach to Regulation" in Corry, Souter and Waterson, Regulating Our Utilities (IPPR, London, 1994), pp 89-90: "Regulators' decisions should also be fully and
Similar views have been expressed by Helm, Veljanovski, Graham and Prosser and Foster. It is also of interest to note that the recent Code of Practice on Access to Government Information, issued by the Parliamentary Commissioner for Administration, contains provisions aimed at requiring administrative bodies to give reasons for their decisions as a matter of general practice. Many of the regulatory bodies have indicated an intention to issue reasoned decisions in the future. Hopefully, therefore, this particular issue is well on the way to being resolved.

publicly justified. If customers are to pay more or companies are to be refused access to particular segments of a market, they should know why. The risk of legal challenge is no ground for imposing secrecy on the decision-making process. It is fear of judicial review that lies behind the lack of transparency in many regulatory decisions. With few exceptions, regulators have been reluctant to spell out the reasons for particular determinations because doing so has meant that aggrieved parties (dominant operators or their competitors) can more easily challenge them in court through the judicial review procedure or (perhaps) by seeking a different construction of the meaning of legislation. As in most areas of regulation policy, there is a balance to be struck here. Regulatory decisions in the United States are often subject to prolonged and costly judicial process, which inhibits regulators and deters operators from making imaginative changes to prices or service offerings. However, it is wrong in principle that administrative decisions affecting the prospects of major British companies, the basic services of every citizen and the livelihoods of hundreds of thousands of employees should be taken without any serious prospect of legal redress or proper appeal procedure." Souter's stakeholder theory, as discussed in chapter 5, posits that the regulatory process should seek to balance the interests of what he describes at pp 9-10 of his essay as "six key stakeholder groups", which he lists as customers, shareholders, utility managers, market entrants, suppliers and employees, with the government acting as a "seventh stakeholder, representing the interests of the community, present and future."

180. See Helm, "British Utility Regulation: Theory, Practice and Reform" in Helm (ed), British Utility Regulation: Principles, Experience and Reform (The Oxera Press, Oxford, 1995), p 68, who observes that: "The publication of reasons for decisions exposes regulators to challenge, both in terms of the consistency of the reasons given relative to their duties and powers, and in terms of their rationality. Both open up the prospect of judicial review....such a requirement (rather than simply a matter of the exercise of discretion) would allow an element of redress."

181. Veljanovski, The Need for a Regulatory Charter (European Policy Forum, London, 1993), pp 3-4, where the author comments: "One major gap in regulatory transparency is the failure of many regulators to give reasons for their actions, and the absence of any legal requirement for them to do so. ...if no reasons are given the courts will often not examine the basis of the decision or hold the absence of reasons as improper. In this knowledge, regulators routinely as a matter of policy seek to avoid legal challenge by failing to give reasons. This practice clearly violates the goal of transparency and common sense notions of due process."

182. Graham and Prosser, supra note 25, p 216.

183. Foster, Natural Justice and the Process of Natural Monopoly Regulation (CRI Discussion Paper 9, London, 1994), p 7, where the author observes: "However the normal practice is, and surely should be, for regulators to give reasons."

184. See Code of Practice on Access to Government Information (Parliamentary Commissioner for Administration, 4 April 1994), p 2 which requires administrative bodies "to give reasons for
(iii) The Scope of Review - Application to Errors of Fact

This leads us to the next major area of interest, which is the legitimate scope of judicial review. At the present time this is a highly topical area, given the well-publicised conflicts between the former Conservative Government and the judiciary over the proper role of the judges in challenging Government decisions. The three 'traditional' grounds of judicial review, procedural irregularity, irrationality and illegality, have been referred to above. In the context of economic regulation, these grounds may give rise to the right to challenge regulatory decisions which have been made in breach of one or more of these requirements. An important issue which arises in this area, and which the US courts have had to grapple with on frequent occasions, concerns the intensity of judicial review, and in particular the extent to which the review process can, or ought to, be allowed to develop into a covert or overt form of appeal on the merits against a regulatory decision.

The question of the extent to which error of fact can constitute a valid ground for judicial review has not been uncontroversial in UK and Commonwealth law. If the courts were to allow a general right of judicial review, based on the existence of any significant factual errors appearing in the administrative decision under review, then the process of judicial review would be virtually indistinguishable in practice from an appeal on the merits. The courts have generally tried to avoid such an outcome, at least in the absence of any express statutory authorisation. However, dicta in some places have suggested the possibility. These include the decision in the case of Smith v. Secretary of State for Social Services [1991] 2 AC 437, in which the House of Lords indicated that it was not precluded from reviewing the facts on which a decision had been based. This decision has been followed in a number of subsequent cases, including the case of R. v. Secretary of State for the Home Department, ex p. R. v. Secretary of State for Social Services, [1994] 3 Cr. App. R. 203, in which the Court of Appeal held that the Secretary of State for Social Services had not acted lawfully in refusing to grant a residence permit to a British citizen who had left the country to marry an American citizen. In this case, the court held that the Secretary of State had acted unlawfully in refusing to grant the residence permit because the decision had been based on factual errors.


186. See the text accompanying note 175 supra.

187. See the discussion in part 6.5.3 of chapter 6.

188. In Commonwealth jurisdictions the leading examples of statutory provisions granting extended powers of review for errors of fact are the Administrative Decisions (Judicial Review) Act 1977 (Aust.), ss 5(1)(b) and 5(3)(b) of which set out a statutory basis for review of an administrative decision where the factual basis of the decision is unsound, and the Canada (Federal Court) Act 1970, s 28(1)(c), which creates a statutory right of review in respect of an administrative decision which is not supported by the evidence. For a general discussion of this area see de Smith, Woolf & Jowell, supra note 28, paras 5-091 to 5-096.
United Kingdom cases have suggested that, to varying degrees, errors of fact in an administrative decision can form the basis for judicial review on the grounds of irrationality or procedural error.¹⁸⁹

Several attempts to rationalise the cases have been made, not always entirely convincingly. Jones points to the need for a material or "cardinal" mistake of fact which has played a central role in leading the administrative decision maker to an incorrect decision. The case for intervention is stronger, in his view, where the mistake has arisen as a result of demonstrable deficiencies in the decision making process.¹⁹⁰

More recently, Yeats has noted the difficulty of formulating a coherent explanatory theory in this area. He also emphasises the relationship between the seriousness of the factual error and the decision reached as a consequence of the error.¹⁹¹ In other Commonwealth jurisdictions, such as New Zealand, a similar debate as to the extent of the mistake of fact doctrine has been ongoing for at least the past 20 years and still remains essentially unresolved. The preponderance of judicial opinion seems to be in favour of treating mistake of fact as a category of unreasonableness or irrationality, rather than as a separate ground for review.¹⁹²

An important issue which arises here is the extent to which courts should embark on the American approach of scrutinising the evidence relied on by an administrative agency in support of its decision. The US APA allows for the reviewing court to hold unlawful and set aside agency decisions found to be "unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute".¹⁹³ The US courts can also set


¹⁹³. See 5 USC §706(2)(E).
aside decisions which are "unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court." 194

Those Commonwealth jurisdictions which have adopted statutory provisions that include factual error as a ground for the review of administrative decisions (most notably Canada and Australia) have not been entirely successful in avoiding some of the nuances of the common law in this area. In Australia, the relevant legislation, contained in the Administrative Decisions (Judicial Review) Act 1977, includes as a ground for review the fact that "there was no evidence or other material to justify the making of the decision," 195 although the effect of this provision is lessened by another provision of the same Act. 196

The Australian courts have been driven by the wording of s 5(3) to take the view that, in general, the 1977 Act largely restates the common law in terms of review of findings of fact. The Australian legislation is a little ambiguous in that s 5(3) does not make it clear whether the reference to a non-existent fact is limited to a fact which can be established by direct evidence, or extends to facts which can be proved as a matter of inference on the balance of probabilities. 197

In the leading case on factual error as a ground for review under the 1977 Act, involving the activities of Alan Bond, one of the more flamboyant Australian entrepreneurs of recent years, the High Court of Australia found it necessary to distinguish between factual errors of varying degrees of seriousness. 198 Mason CJ, in

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194. See 5 USC §705 (2)(F).


196. See s 5(3), which provides:

"(3) The ground specified in paragraph (1)(h) shall not be taken to be made out unless:

(a) the person who made the decision was required by law to reach that decision only if a particular matter was established, and there was no evidence or other material (including facts of which he was entitled to take notice) from which he could reasonably be satisfied that the matter was established; or

(b) the person who made the decision based the decision on the existence of a particular fact, and that fact did not exist."

197. See the discussion in Administrative Law Service (Butterworths Australia, Sydney, 1995), para 344.

his judgment in that case, noted that s 5(1)(h) of the 1977 Act should not be construed in such a way as to allow findings of fact to be reviewed independently of the decision ultimately made by the administrative tribunal.\textsuperscript{199} The courts in Australia therefore remain reluctant to embark on a wide ranging review of the factual basis for administrative decisions, despite the powers conferred by the 1977 Act.\textsuperscript{200} It seems that it may be some time before a 'hard look' approach attracts judicial favour in the higher Australian courts.

In Canada, legislation allowing for limited powers of review on the basis of error of fact is in force at the federal level\textsuperscript{201} and in Ontario.\textsuperscript{202} The Canadian courts, as with their Australian counterparts, have generally not sought to take an expansive view of their role under these statutory powers.\textsuperscript{203} While statutory powers of review for error

\textsuperscript{199.} Ibid 341: "Powerful considerations support the correctness of this view. The Administrative Appeals Tribunal Act 1975 (Cth) (the AAT Act) provides specifically for a review on the merits by the Administrative Appeals Tribunal. It is scarcely to be supposed that the Parliament, in so providing, nevertheless intended to invest the Federal Court with a similar jurisdiction under the AD(JR) Act, for that would be the effect of that Act if it were to confer jurisdiction to review findings of fact generally....To expose all findings of fact, or the generality of them, to judicial review would expose the steps in administrative decision-making to comprehensive review by the courts and thus bring about a radical change in the relationship between the executive and judicial branches of government. Amongst other things, such a change would bring in its train difficult questions concerning the extent to which the courts should take account of policy considerations when reviewing the making of findings of fact and the drawing of inferences of fact."

\textsuperscript{200.} For an example of a similar approach taken by the High Court of Australia in 1986 see Minister for Aboriginal Affairs v Peko-Wallsend Ltd (1985-86) 162 CLR 24 at 42 per Mason J: "So too in the context of administrative law, a court should proceed with caution when reviewing an administrative decision on the ground that it does not give proper weight to relevant factors, lest it exceed its supervisory role by reviewing the decision on its merits."

\textsuperscript{201.} At the federal level s 28(1)(c) of the Canada (Federal Court) Act RSC 1970, c. 10 (2nd Supp.) provides that: "...the Court of Appeal has jurisdiction to hear and determine an application to review and set aside a decision or order, other than a decision or order of an administrative nature not required by law to be made on a judicial or quasi-judicial basis... upon the ground that the board, commission or tribunal...(c) based its decision or order on an erroneous finding of fact that it made in a perverse or capricious manner or without regard to the material before it."

\textsuperscript{202.} In Ontario, s 2(3) of the Judicial Review Procedure Act Act RSO 1980, c. 224 provides as follows: "Where the findings of a tribunal made in the exercise of a statutory power or decision are required by any statute or law to be based exclusively on evidence admissible before it and on facts of which it may take notice and there is no such evidence and there are no such facts to support findings of fact made by the tribunal in making a decision in the exercise of such power, the court may set aside the decision on an application for judicial review."

\textsuperscript{203.} For a discussion of the relevant case law see Evans, Janisch, Mullan and Risk, Administrative Law (Emond Montgomery Publications Ltd, Toronto, 3rd ed, 1989), ch 10, entitled " No
of fact are therefore in force in both Australia and Canada, the higher courts in both jurisdictions have therefore been reluctant to enter into any wholesale review of administrative decisions on this ground. The adoption of such an approach in the United Kingdom would of course require the reviewing court to have access to the evidence relied upon by the administrative body in question in reaching its decision, as was noted in chapter 6.204

These considerations as to the scope of review raise the more general issue of the extent to which the court should defer to agency decisions, an issue which was discussed in some detail in chapter 6.205 In the US context, the traditional American suspicion of bureaucratic processes has generated support for a judicial process to maintain checks and balances in accordance with separation of powers principles, as writers such as Rosenbloom have noted.206

At the other end of the spectrum, other US commentators have advocated judicial deference to agency decision-making. As was noted in chapter 6, such a view has a long pedigree, dating back at least to Professor Landis in the New Deal era, who placed

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204. See the discussion in part 6.5.3(ii) of chapter 6.

205. Ibid.

206. Rosenbloom, Public Administration and Law. Bench v Bureau in the United States (Marcel Dekker Inc, New York, 1983), p 50: "... it can be seen that members of the Supreme Court have expressed great concern with the persuasiveness of public bureaucracy, its departure from the standards of procedural due process, its tendency to debilitate democratic citizenship under the Constitution, and its ability to frustrate the will of elected political authorities.... If public administrative power is perceived as being exercised largely on an independent basis, the arguments for restraint in the use of judicial review against it lose much of their force. Under such circumstances, judicial review is not necessarily antimajoritarian." For similar views see Sunstein, "Deregulation and the Hard Look Doctrine" [1983] Sup. Ct. Rev. 177, 212; Ferejohn and Shipan, "Congressional Influence on Bureaucracy" (1990) 6 J L Econ & Org 1 at 17: "In this sense, statutory judicial review can be a 'democratic' device that induces the agency to be more responsive to congressional preferences than it would be without such a mechanism." For a more philosophical discussion of the relationship between judicial review and democratic theory see Dworkin, "Equality, Democracy, and Constitution: We the People in Court" (1990) 28 Alberta LR 324; Dyzenhaus, "The Politics of Deference: Judicial Review and Democracy" in Taggart (ed), The Province of Administrative Law, supra note 131, chapter 13.
great stock on the expert nature of the regulatory agencies and recommended that they be permitted to operate unhindered in their particular areas of expertise.\footnote{207}

In more recent times objections to judicial intervention in the decisions of administrative agencies have focused not only on the comparative lack of expertise of the courts but also on whether judges are the most suitable persons for dealing with broadly defined social, economic and political issues, particularly where these involve disputes between a number of parties.\footnote{208} Schwartz has summarised the essential nature of the problem in his text on administrative law.\footnote{209}

The US courts have sought to steer a path between excessive deference and excessive judicial intervention by the use of the device known as "hard look" review. The evolution of this concept has earlier been described in chapter 6.\footnote{210} It will be recalled that the doctrine involves the court determining on review whether, in reaching its decision, the agency has taken a "hard look" at the evidence on the record and the alternative policies available to it, and has properly exercised its discretion after taking all the relevant considerations into account.

The 'hard look' approach has attracted some degree of support in the United Kingdom.\footnote{211} Other UK commentators, such as Craig, have been more sceptical as to

\begin{footnotesize}
\footnote{207}{See the discussion in part 6.2.3(ii) of chapter 6.}
\footnote{208}{For differing views in this area see Shapiro, \textit{The Supreme Court and Administrative Agencies} (Free Press, New York, 1968), p 102 (arguing that both agencies and courts are equally well placed to reach competent decisions on the same issues); Horowitz, \textit{The Courts and Social Policy} (Brookings Institution, Washington DC, 1977), pp 274-284 (arguing that court procedures are inherently unsuitable for adjudicating on matters of social or economic policy).}
\footnote{209}{Schwartz, \textit{Administrative Law} (Little, Brown and Company, Boston, 3rd ed, 1991), p 624: "If the scope of review is too broad, agencies are turned into little more than media for the transmission of cases to the courts. That would destroy the value of agencies created to secure the benefit of special knowledge acquired through continuous administration in complicated fields. At the same time, courts should not rubber-stamp agencies; the scope of judicial inquiry must not be so restricted that it prevents full inquiry into the question of legality. If that question cannot be properly explored by the judge, the right to review becomes meaningless."}
\footnote{210}{See the discussion in part 6.5.3(i) of chapter 6.}
\footnote{211}{See for example Harden and Lewis, \textit{The Noble Lie}, (Hutchinson, London, 1986), pp 272-283, who comment as follows at p 278: "What we wish to suggest is that some version of the 'hard look' doctrine might be explored with a view to repairing some of these deficiencies [in administrative decision-making]. The need is to ensure both that reasoned decisions and choices are made and that procedures are adopted to enfranchise potential and actual constituencies who might wish to contest proposals of a major sort." For recent judicial endorsements from New}
\end{footnotesize}
the usefulness of such a doctrine, arguing that such an approach would embroil the courts in contentious policy issues without the assistance of a clear policy framework in the legislation in question.\textsuperscript{212}

The 'hard look' approach has had a mixed reception in the United States, as was noted in chapter 6, and the concept has also given rise to differing views in Britain.\textsuperscript{213} It is clear that if a 'hard look' approach was to be adopted in the United Kingdom substantial changes to the administrative process would be required, one example being the need for regulatory bodies to maintain an adequate record. While there may be much merit in exploring such an approach further, it must also be recognised that proposals of this kind are likely to generate a very large lump in the administrative throat.

8.4 Mechanisms for Introducing Modified APA-Type Procedures in the United Kingdom.

8.4.1 The Constitutional Position

We have seen earlier that in the United States the vesting of substantial discretionary powers in the independent regulatory commissions has been an issue which continues to attract controversy at the level of constitutional theory.\textsuperscript{214} Such a situation has arisen because the US courts have generally chosen to interpret the provisions of the

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\textsuperscript{212}See Craig, \textit{Public Law and Democracy in the United Kingdom and the United States of America} (Clarendon Press, Oxford, 1990), pp 182-187. Craig comments at pp 186-187 that: "The very decision to make increased provision for consultation rights, coupled with the desire for a reasoned consideration of policy alternatives by the administrator, will, therefore, lead the courts into making decisions which can constrict the ambit of substantive choices at the disposal of the agency. ...these judicial inquiries will take place and can only take place, against the backdrop of the enabling legislation."

\textsuperscript{213}See the discussion in part 6.5.3(ii) of chapter 6.

\textsuperscript{214}See for example the discussion in part 4.8.4 of chapter 4.
US Constitution prescribing the functions of the three branches of government in such a way as to promote observance of the doctrine of separation of powers.

In the United Kingdom, which has no written constitution and where the doctrine of separation of powers has not been observed to the same extent, such constitutional objections have been more muted, where they have been raised at all. The administrative process itself has of course not been without its critics. The opposition expressed earlier this century by figures such as Lord Hewart is well known, although even Dicey, a staunch upholder of the rule of law, recognised the inevitability of administrative action in the United Kingdom context.

Such pragmatic views have largely characterised English constitutional theory in this area. The debate over the constitutional status of administrative rule making has therefore tended to focus not so much on the constitutional validity of the process from a separation of powers perspective, as in the United States, but rather on the degree of public participation and parliamentary supervision involved in the process of passing delegated legislation and administrative rule making.

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217. Dicey, An Introduction to the Study of the Law of the Constitution (Macmillan Education Limited, London, 10th ed, 1959), pp 52-53: "The cumbersomeness and prolixity of English statute law is due in no small measure to futile endeavours of Parliament to work out the details of large legislative changes. This evil has become so apparent that in modern times Acts of Parliament constantly contain provisions empowering the Privy Council, the judges, or some other body, to make rules under the Act for the determination of details which cannot be settled by Parliament. But this is only an awkward mitigation of an acknowledged evil, and the substance no less than the form of the law would, it is probable, be a good deal improved if the executive government of England could, like that of France, by means of decrees, ordinances, or proclamations having the force of law, work out the detailed application of the general principles embodied in the Acts of the legislature. In this, as in some other instances, restrictions wisely placed by our forefathers on the growth of royal power, are at the present day the cause of unnecessary restraints on the action of the executive government."
This difference is significant when the possible adoption of more formal consultation and participation procedures comes to be considered in the United Kingdom context. While in the US, a statutory enactment such as the APA has served to give additional constitutional legitimacy to the processes of administrative action, in the United Kingdom its primary justification might rather be seen as a means of increasing the legitimacy of the administrative process from a functional rather than a constitutional perspective. Such functional considerations will now be addressed.

8.4.2 Common Law Influences

(i) Introduction

This part of the chapter considers the extent to which the courts and the common law might seek to impose consultation and participation requirements in the United Kingdom, without the need for a specific empowering statute along the lines of the US Administrative Procedure Act 1946. The discussion includes some consideration of the imposition of public hearing requirements in relation to certain regulatory decisions.

To begin with consultation and participation requirements, it was noted earlier in this chapter that as a general principle the courts have proved reluctant to impose such requirements in the absence of express statutory authority for such procedures or a supervening legitimate expectation of some kind. It is instructive to consider the extent to which consultation and participation requirements might be imposed by the courts as a fundamental requirement of the common law in the absence of statutory provisions.

(ii) Commonwealth Experience

In those Commonwealth jurisdictions that have adopted a codified Charter or Bill of Rights, such as Canada and New Zealand, this issue has attracted some degree of judicial attention. In Canada, attention has focused on the provisions of the Canadian

218. See the discussion in parts 8.2.2 (ii) and (iii) of this chapter.
Charter of Rights and Freedoms, and in particular s 7 of the Charter, conferring a right to life, liberty and security of the person. \(^{219}\) While on its face s 7 of the Charter might not obviously lend itself to an argument that the public has a right to participate and be consulted in relation to administrative actions, such an interpretation of s 7 has been advocated by at least one Canadian academic writer. \(^{220}\) Professor Jackman has argued that the rights contained in s 7 of the Charter must be construed so as to confer on citizens a "meaningful opportunity to participate in the decision-making process" and that in the regulatory context the s 7 guarantee is of "the right to access to the decision-making process and to the actual decision-maker, and to any information which is necessary for effective participation." \(^{221}\)

In the Canadian regulatory context the Charter provisions have been applied to regulatory bodies \(^{222}\) and the Canadian courts have also held that legislation conferring a discretion on an administrative tribunal is presumed not to infringe the Charter unless the infringement is prohibited expressly or by necessary implication. \(^{223}\) However no reported Canadian case so far appears to have gone as far in its interpretation of s 7 of

\(^{219}\) Section 7 of the Canadian Charter provides as follows: "Every one has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice." For a discussion of the evolution of this principle in Canada and its relationship to similar provisions in the United Nations Charter and the International Covenant on Civil and Political Rights see Kindler v Canada [1991] 2 SCR 779 (dealing with the application of s 7 to an extradition request from the United States directed to a Canadian resident who would face the death penalty for murder if extradited to the US). The literature on the ambit of the Canadian Charter provisions is vast and the writer will not attempt to reproduce it here. However one recent comparative study which is of interest is found in an article by Penner, "The Canadian Experience with the Charter of Rights: Are there Lessons for the United Kingdom?" [1995] PL 104.

\(^{220}\) See Jackman, "Rights and Participation: The Use of the Charter to Supervise the Regulatory Process" (1990-91) 4 CJALP 23.

\(^{221}\) Ibid p 28.

\(^{222}\) See for example National Corngrowers Association v Canada (Import Tribunal) [1990] 2 SCR 1324; Re Law Society of Manitoba and Savino (1983) 1 DLR (4th) 285; and British Columbia Securities Commission v Branch et al (1995) 123 DLR (4th) 462. While the Charter itself, by virtue of s 32, only applies to the actions of federal and provincial Canadian governmental bodies, the terms of s 32 have been interpreted sufficiently widely to extend to self regulatory bodies exercising functions of a public character or in the public interest. For a discussion of these issues see Hogg, Constitutional Law of Canada (Carswell, Toronto, 3rd ed, 1992), pp 847-850; Gibson, "Distinguishing the Governors from the Governed: The Meaning of 'Government' under Section 32(1) of the Charter" (1983) 13 Manitoba LJ 505.

\(^{223}\) Slaight Communications Inc v Davidson [1989] 1 SCR 1038.
the Charter as Professor Jackman has suggested is desirable. It therefore remains to be seen whether the Canadian courts will be prepared to impose consultation and participation requirements in this way in the absence of express statutory authority. This appears dubious given that a number of Canadian commentators have doubted the commitment of the Canadian Courts to the achievement of these goals. Other Canadian legal writers have maintained that the Charter imposes a constitutional requirement that administrative tribunals act in accordance with natural justice and the rule of law and have suggested that the remedy of judicial review should be used to enforce Charter provisions where necessary.

In New Zealand, which enacted a Bill of Rights in statutory form in 1990 in the New Zealand Bill of Rights Act 1990, the scope for similar arguments appears rather more limited. Unlike the Canadian Charter, the New Zealand Bill of Rights is not entrenched and can be overridden by an ordinary statute. The difficulty with the New Zealand legislation, in the present context, is that it does not contain a similar provision to s 7 of the Canadian Charter. There are provisions in the New Zealand legislation protecting the right to life and preserving the right to seek judicial review of the decisions of tribunals and public authorities. However, there is no general reference to "life,

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225 See for example McLachlin, "Rules and Discretion in the Governance of Canada" (1992) 56 Sask LR 167, 176-177.


227 See New Zealand Bill of Rights Act 1990, ss 8 and 27(2). In a recent New Zealand decision the 'right to life' conferred by s 8 of the Act was held not to include the right to material security based on economic and social factors. See *Lawson v Housing New Zealand* (High Court, Auckland, Williams J, M 538/94, 29/10/96), distinguishing Canadian authority such as *Singh and others v Minister of Employment and Immigration* [1985] SCR 177.
liberty and security of the person” and there are no provisions guaranteeing “equality before the law” or “access to justice” as such, although these were the subject of some discussion prior to the legislation being enacted.228

Section 3 of the New Zealand Bill of Rights Act is aimed at protecting fundamental rights and freedoms from unreasonable encroachment by the legislative, executive or judicial branches of the government of New Zealand or by “any person or body in the performance of any public function, power or duty conferred or imposed on that person or body by or pursuant to law.” This provision has been held to render the Bill of Rights Act applicable to the activities of privatised enterprises carrying on public functions, such as television broadcasters,229 and also to corporatised bodies such as NZ Post Limited.230

While in principle the New Zealand legislation would therefore be applicable to the activities of regulatory bodies exercising public functions this is of limited usefulness in the present context. This is the case because, as noted above, it seems unlikely that any of the provisions of the Act could be construed in such a way as to require the observance of participation and consultation requirements in relation to the administrative process.

From time to time the New Zealand courts have been prepared to apply the provisions of international conventions to which New Zealand is a party, such as the International Covenant on Civil and Political Rights 1966.231 However, again, no reported New Zealand case to date has considered the extent to which any international convention might impact on the provision of consultation and participation requirements as part of the administrative process.

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230. Federated Farmers of NZ (Inc) v NZ Post Limited [1990-92] NZBORR 339. For a discussion of these cases see Chen, supra note 133, at 75-78.

In Australia, which has no statutory Bill of Rights legislation at either the state or federal level, there has been considerable, and often quite acrimonious, debate over the extent to which the higher Australian courts can reach decisions based on a recognition of fundamental human rights. Australian decisions in this area in recent years have generated considerable controversy, not so much because the claimed fundamental human rights have been regarded as undesirable in themselves, but because the judges have been accused of overstepping their constitutional function by seeking to determine the scope of these fundamental rights through judge-made law.

(iii) The UK Position

A similar debate has occurred in the United Kingdom in recent years. The authors of the 5th edition of de Smith have supported judicial recognition of fundamental human rights in this way.

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232. See for example the decisions of Justice Murphy in the High Court of Australia during the period 1975 to 1986, who sought to derive certain fundamental rights by implication from the Australian Constitution. Relevant cases include McGraw-Hinds Australia Pty Ltd v Smith (1979) 144 CLR 633, 668-670 (asserting fundamental rights in relation to freedom from slavery, serfdom, maintenance of the rule of law and freedom of movement and communication); Uebergang v Australian Meat Board (1980) 145 CLR 266, 311-312 (freedom of speech, assembly, communication and travel) and Miller v TCN Channel 9 Pty Ltd (1986) 67 ALR 321, 336-338 (freedom of speech, communication and travel). For a discussion of these issues see Winterton, "Extra-constitutional Notions in Australian Constitutional Law" (1986) 16 Fed LR 223 at 228-235; J & R Ely (eds), Lionel Murphy: The Rule of Law (Akron Press, Sydney, 1986), chapters 9 and 10; Lee, "The Australian High Court and Implied Fundamental Guarantees" [1993] Pub Law 606; Kennett, "Individual Rights, The High Court and the Constitution" (1994) 19 Melb ULR 581.

233. See Winterton, ibid at p 235: "It must, nevertheless, be conceded that few would dissent from the substance of the fundamental principles already recognised, although many, including the present writer, would dispute their supposed status as constitutional norms."

234. See for example Raymond v Honey [1982] AC 1 (a prisoner retains all rights not expressly or impliedly removed by statute); Golder v United Kingdom (1975) 1 EHR 524; R v Secretary of State for Home Affairs, ex parte Leech (No 2) [1994] QB 198 (regulations permitting a prison governor to intercept and monitor correspondence between a prisoner and his lawyer held to infringe the prisoner's basic constitutional rights). The issue of whether Britain should have a formalised Charter or Bill of Rights incorporating guarantees of fundamental freedoms attracts periodic discussion in the literature. See for example Mann, "Britain's Bill of Rights" (1978) 44 LQR 512; Lester "Fundamental Rights: The United Kingdom Isolated?" [1994] PL 46.

235. de Smith, Woolf & Jowell, supra note 28, para 6-056: "The foundation in precedent for the presumption against the infringement of human rights in English domestic law is therefore solid. The foundation in theory is less apparent and barely discussed. It is unnecessary to seek the source of human rights in natural law when they can be properly viewed as integral features of a
The courts of the United Kingdom have been called upon to consider the application of Conventions such as the European Convention for the Protection of Human Rights and Fundamental Freedoms ("ECHR"). In the well known case of R v Secretary of State for the Home Department, ex parte Brind, the Home Secretary had issued directives to the IBA under the then Broadcasting Act 1981 prohibiting broadcasts of statements by representatives of banned organisations in Northern Ireland. This decision was challenged by representatives of the press in the Divisional Court and the Court of Appeal, one argument being that the Home Secretary's directives were an unlawful restriction of the right to freedom of expression. The applicants for judicial review of the Home Secretary's decision argued that the actions were in breach of Article 10 of the European Convention on Human Rights, which included the freedom "to receive and impart information and ideas without interference by public authorities".

The Court of Appeal held, on this point, that while ambiguities in primary legislation were to be interpreted in a manner consistent with the international treaty obligations of the United Kingdom, the same presumption did not apply to executive action or delegated legislation where the terms of the primary enabling legislation were unambiguous. Lord Donaldson of Lymington MR observed that the Convention was not part of English domestic law but was simply an international treaty to which the United Kingdom was a party. The duty of the English courts was to decide disputes in accordance with English domestic law and therefore, in his Lordship's view, the Convention was of limited application.

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236. [1990] 1 All ER 469 (CA).

237. Ibid p 477: "It follows from this that in most cases the English courts will be wholly unconcerned with the terms of the convention. The sole exception is when the terms of primary legislation are fairly capable of bearing two or more meanings and the court, in pursuance of its duty to apply domestic law, is concerned to divine and define its true and only meaning. In that situation various prima facie rules of construction have to be applied, such as that, in the absence of very clear words indicating the contrary, legislation is not retrospective or penal in effect. To these can be added, in appropriate cases, a presumption that Parliament has legislated in a manner consistent, rather than inconsistent, with the United Kingdom's treaty obligations."
The court went on to reject an argument that the delegated power to legislate or the authority to take executive action were subject to the limitation that such actions were consistent with the European Convention.\textsuperscript{238} The Scottish courts have taken a similar view of the enforceability of the Convention.\textsuperscript{239} This difficulty would not of course arise if the Convention had been fully incorporated into UK domestic law.\textsuperscript{240} \textit{Brind} was a decision based on particular facts where the empowering legislation conferred a broad discretion on the decision maker. Even so the correctness of this decision is open to question, particularly in terms of the extent to which the ECHR might be applied by an English court. This issue is discussed further in the following section.

8.4.3 The European Convention on Human Rights - Further Possibilities

While cases like \textit{Brind} give little cause for optimism in this area, there are good reasons to suggest that such authorities such as this may not necessarily represent the last word in this area. Other judges and academic commentators have taken the view that even if the ECHR is not directly binding as part of the domestic law of the United Kingdom, its provisions can legitimately be taken into account by the English courts in developing the common law.\textsuperscript{241}

\textsuperscript{238.} \textit{Ibid} p 478: "This I unhesitatingly and unreservedly reject, because it involves imputing to Parliament an intention to import the convention into domestic law by the back door, when it has quite clearly refrained from doing so by the front door." For a discussion of the terms of the European Convention on Human Rights and its relationship to UK law see Thompson, \textit{supra} note 215, pp 266-270. More recently, in \textit{R v Ministry of Defence, ex parte Smith} [1996] 1 All ER 257, the Court of Appeal held that the obligations imposed on the United Kingdom to comply with rights conferred by the ECHR could not be enforced in UK courts. For a criticism of this decision see Lord Lester of Herne Hill QC, "Government compliance with international human rights law: a new year's legitimate expectation" [1996] PL 187.

\textsuperscript{239.} See \textit{Surjit Kaur and another v The Lord Advocate} [1980] 3 CMLR 79.


\textsuperscript{241.} See for example the discussion in this area in de Smith, Woolf & Jowell, \textit{supra} note 28, paras 6-053 - 6-058, including in particular para 6-058 where the authors note: "Finally, it should
The debate over whether or not the ECHR should be incorporated into UK domestic law continues unabated and it is no secret that the present Master of the Rolls, Lord Woolf, and the new Lord Chief Justice, Sir Thomas Bingham, are strongly in favour of incorporating the Convention into domestic law. Even apart from the issue of incorporation, a respectable body of judicial and academic opinion, as noted above, favours the view that the Convention itself can be an authoritative source for

be noted that the courts may be placing too restrictive an interpretation upon the view of the majority in Brind that, in construing the exercise of power in purely domestic law, regard may not be had to the European Convention of Human Rights. In some cases it has been assumed that English legislation was intended to implement the Convention's designs.; Hunt, Using Human Rights Law in English Courts (Hart Publishing, Oxford, 1997); R v Secretary for State for the Home Department, ex parte Kevin McQuillan, (The Independent, 23 September 1994) referred to in de Smith, Woolf & Jowell, supra note 28 at para 6-058; Laws, "Is the High Court the Guardian of Fundamental Constitutional Rights?" [1993] PL 59; Allan, Law, Liberty and Justice: the legal foundations of British constitutionalism (Clarendon Press, Oxford, 1993) at pp 254-262, who takes the view that the European Convention authoritatively states what he considers to be a constitutional convention in respect of fundamental human rights. For some reservations about the implications of such an approach in practice see Harden, "The Fundamental Laws of the Kingdom. Review of T R S Allan: Law, Liberty and Justice: the legal foundations of British constitutionalism" [1995] PL 298 at 301: "More generally, the claim that the constitutional limits to the legislative authority of Parliament are determined by the courts creates a dilemma. Such authority as we have on the question suggests that judges will refuse to listen to arguments that a statute exceeds the legislative authority of Parliament. They do not weigh the arguments and then pronounce them to be deficient; they refuse to listen. Their ground for so doing is that they have no jurisdiction in the matter. If judges really do have responsibility for determining the limits to the legislative authority of Parliament and if we take what they say at face value, then they are patentally failing to discharge the unique responsibility which, according to Allan, the common law constitution places on their shoulders."

242. See for example Jowell & Lester, "Beyond Wednesbury: Substantive Principles of Judicial Review" [1987] PL 369; Laws, supra note 241, pp 61-62. For a summary of the cases in which the provisions of the Convention and the question of its incorporation into domestic law have been discussed see Wade and Bradley, Constitutional and Administrative Law (Longman, London and New York, 10th ed, 1985), pp 582-584; Lester, "Fundamental Rights: The United Kingdom Isolated?" supra note 234 at 61-66: "Isolated in most of the democratic Commonwealth, we are also isolated in democratic Europe. Unlike the other European member States, we have neither a legally enforceable Bill of Rights, nor a legally enforceable Convention. The citizens of West Germany and France and of many of the smaller European countries, have both. And, while the Governments and peoples of new Commonwealth countries continue to empower British judges to protect fundamental rights when interpreting their constitutions in appeals to the Privy Council, our Government and Parliament continue to exclude them from performing that task in British cases." See also Beyleved, "The Concept of a Human Right and Incorporation of the European Convention on Human Rights" [1995] PL 577. For a more sceptical view see "Editorial Comments, Fundamental rights and the common European values" (1996) 33 CMLR 215. Labour Party policy remains in favour of incorporation of the ECHR into UK domestic law. See Wadham, "Bringing rights home: Labour's plans to incorporate the European Convention on Human Rights into UK Law" [1997] Public Law 75.

243. See article by Frances Gibb in The Times, 25 May 1996: "Reforming judges take over at the top".
the judicial development of the common law, just as decisions of superior courts in
other common law jurisdictions are accepted as being persuasive authorities by
English courts, along with recognised legal texts and similar sources of law.\textsuperscript{244}

Another avenue which has been suggested here is that the provisions of the ECHR, or
at least the fundamental rights which they guarantee, could be enforced through the
European Court of Justice as part of Community law, given that the member states
are themselves parties to the Convention and the provisions of the Convention are
recognised in the Single European Act.\textsuperscript{245}

Given this increasing willingness, at least among certain sections of the judiciary, to
afford recognition (albeit obliquely) to the provisions of the ECHR, some
consideration should be given here to the issue of whether or not the Convention can
be prayed in aid for the purposes of implying consultation and participation
requirements into the regulatory process.

It is appropriate to begin this exercise by a brief description of the ECHR and the
context in which it operates. The European Convention, more correctly called the
Convention for the Protection of Human Rights and Fundamental Freedoms, was

\textsuperscript{244} See for example Laws, \textit{supra} note 241, p 65: "So, in private law cases of this kind, the door is
open for the use by the English courts of the Convention texts as a tool in the development of the
common law. More I think, ought to be done. There is for example scope for the elaboration of
an actionable right of privacy by building on the cause of action in confidentiality and by
reference to Article 8." For a summary of the cases in this area see Jones, "The Devaluation of

\textsuperscript{245} For the legal justification for this suggestion see \textit{Memorandum on the Accession of the
European Communities to the Convention for the Protection of Human Rights and
Fundamental Freedoms, Bulletin of the European Communities, Supplement 2/79} at p 10
(arguing that the Member States are already bound by the ECHR on the proper construction
of the European Treaty); Grief, "The Domestic Impact of the European Convention on
Human Rights as Mediated through Community Law" [1991] PL 555; Koopmans, "European
standards are observed should be settled by the courts, as article 6 of the European
Convention implies, and as the evolution of Community law testifies. Political institutions
such as parliaments and cabinets are not the appropriate bodies for fulfilling this task: they
have been elected or appointed for quite different purposes. It is not their work to check
whether their statutes and decisions are compatible with the standards of European public
law. That is judicial work, which can be performed by the House of Lords or the Court of
Appeal just as well as by the European Court of Human Rights or by the Court of Justice of the
Community." For a further discussion of the theoretical aspects which arise here see Lord
Lester of Herne Hill QC, "European Human Rights and the British Constitution" in Jowell &
CMLR 669; Weiler and Lockhart, "Taking Rights Seriously: The European Court and its
adopted by the Members of the Council of Europe in 1950. The Convention itself is one of several international conventions relating to human rights. There was considerable initial debate as to whether the United Kingdom would accede to the Convention but it was not in fact until 1965 that the British Government decided to accord individuals the right to petition the European Court of Human Rights in Strasbourg.

The ECHR itself was progressively ratified by its member states during the 1950s and 1960s. It consists of a number of Articles setting out various fundamental human rights, which are contained in Section I of the Convention. To ensure the observance of these rights two bodies were established, being a European Commission of Human Rights ("the Commission") and a European Court of Human Rights ("the Court").

The members of the Commission are elected by a vote of the Committee of Ministers for a period of six years and sit in their individual capacity. Alleged breaches of the Convention may be referred to the Commission by the member states and the Commission is also empowered to receive petitions from any individual, organisation or group who claims to be affected by a violation of the Convention provisions. Applicants must first exhaust any domestic remedies they may have and the

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247. For a detailed discussion of the tortuous political background to UK recognition of the Convention see Lester, supra note 234, pp 49-61.


249. See Section III, Articles 20-25 of the ECHR.
Commission may decline to consider petitions which amount to an abuse of process.\textsuperscript{250}

On a petition being accepted the Commission undertakes whatever investigation it considers necessary and may appoint a sub-Commission for this purpose. If the matter at issue is resolved by the Commission then a report is sent to the member states, the Committee of Ministers and the Secretary-General of the Council of Europe for publication.\textsuperscript{251} If the matter is not resolved at this stage then the Commission states its opinion on the matter and a case can then be presented to the Court.\textsuperscript{252}

The Court itself consists of judges drawn from each of the members of the Council of Europe. The judges are elected by a majority of votes cast by nominees of the Council of Europe in accordance with the procedure set out in Section IV of the Convention.\textsuperscript{253} Judges of the Court are elected for a period of nine years and may be re-elected. The Court elects its own President and Vice President, who are also eligible for re-election.\textsuperscript{254} Individual cases are heard by seven judges and the Court has jurisdiction to interpret and apply all questions arising under the Convention. The Court may only deal with a case after the Commission has confirmed that the matter cannot be resolved by it and a reference to the Court must be made within a period of three months from the date of the Commission’s report.\textsuperscript{255}

\textsuperscript{250} Articles 26-27.

\textsuperscript{251} Articles 28-30.

\textsuperscript{252} Articles 32, 48 and 49.

\textsuperscript{253} Articles 38-39. I was fortunate, in writing this part of the chapter, to be able to enlist the assistance of Professor Ronald St J Macdonald, Judge of the European Court of Human Rights for the member state of Liechtenstein. I had previously studied under Professor Macdonald when completing an LLM at Dalhousie University in Halifax, Canada in 1987. When I mentioned to him I was interested in the scope of application of Article 6(1) of the European Convention he kindly invited me to come to Strasbourg to observe the Court sitting. I spent several interesting and informative days in Strasbourg from 26-29 June 1996 and am grateful to Judge Macdonald for showing me the inner workings of the Court and supplying me with much valuable reference material for this part of the chapter. (I am also grateful to him for introducing me to some of the finer restaurants of Strasbourg!)

\textsuperscript{254} Articles 40-41.

\textsuperscript{255} Articles 42-49.
If the Court finds that one of the member states has acted in contravention of the Convention and if the internal law of that member state allows only “partial reparation” to be made to the affected party, the Court has power to “afford just satisfaction to the injured party”. The Court must give reasons for its judgment and the Court’s judgment is final and binding on the member states. Execution of the judgment is supervised by the Committee of Ministers. Section V of the Convention contains various provisions requiring the member states to provide support and assistance to the Court in the discharge of its functions.

As has been noted above, the Convention has not yet been directly incorporated into the law of the United Kingdom. However, a number of individual petitioners from the United Kingdom have had cases determined by the Court with varying degrees of success. From the perspective of the present exercise, our attention must necessarily focus on Article 6(1) of the Convention and a discussion of the jurisprudence arising from this Article now follows.

Article 6(1) sets out a general right to “a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law.” This right extends to the determination of civil rights and obligations as well as criminal charges.

256. Article 50.
257. Articles 50-55.
258. Articles 57-66.
260. The full text of Article 6(1) reads as follows:

"(1). In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly but the press and public may be excluded from all or part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice."
the face of it, the use of this provision to confer rights of consultation and participation in processes of economic regulation might not seem particularly feasible. However the case law interpreting Article 6(1) has made it clear that, in the civil context, the ambit of the provision extends to the activities of administrative bodies. In several cases, for example, the Court has determined that Article 6(1) applies where the actions of an administrative body have a decisive effect on the civil rights of an individual petitioner.\textsuperscript{261}

In a recent cases the Court has recognised that rights conferred on a petitioner by virtue of a licence, such as a taxi licence, might still be subject to Article 6.\textsuperscript{262} However, the Court’s jurisprudence on Article 6 has still tended to stress the fact that

\textsuperscript{261} See for example \textit{Kaplan v United Kingdom} (Application No. 7598/76, report 21 DR 5) where the Commission held that the statutory powers of the Secretary of State for Trade to control insurance companies affected the petitioner's civil rights, which were subject to Article 6 of the Convention, so that restrictions on an insurance company's business would require a prior hearing. See also the \textit{Ringeisen judgment} (16.7.71, Series A, No. 13), which held that Article 6 was applicable to every proceeding "the result of which is decisive for private rights and obligations." In \textit{Silver v United Kingdom} (1983) 5 EHRR 347 a refusal by a prison authority to allow the petitioner to take legal advice on his rights as a prisoner was held to breach Article 6(1). However the Court reached the opposite conclusion in \textit{Lithgow v United Kingdom} (1986) 8 EHRR 329 where the petitioners claimed that the compensation they had received from the Secretary of State for Industry on the nationalisation of certain assets was said to be grossly inadequate. The Court held by a majority that the fact that the petitioners were denied access to an independent tribunal for the purpose of assessing compensation was not a breach of Article 6(1). The relevant UK legislation was legitimately designed to avoid a multiplicity of arbitral claims by individual shareholders and the Court considered that there was reasonable proportionality between the means employed and the end to be achieved. (See paras 193-197 of the Court's judgment).

\textsuperscript{262} See \textit{Pudas v Sweden} (1987) 10 EHRR 380 at 389: "37. In the Court's view however, these features of public law do not suffice to exclude from the category of civil rights under Article 6(1) the rights conferred on the applicant by virtue of the licence. The maintenance of the licence to which the applicant claimed to be entitled was one of the conditions for the exercise of his business activities. Furthermore, public transport services in Sweden are not ensured by a State monopoly but both by public bodies and by private persons. At least in the latter event, the provision of such services takes the form of a commercial activity. It is carried out with the object of earning profits and is based on a contractual relationship between the licence-holder and the customers." However, the Court reached the opposite view in \textit{Fischer v Austria} (1995) 19 EHRR 349, where the revocation on environmental grounds of a refuse tip licence was held to be based on objective criteria, as determined from experts' reports, and left little scope for administrative discretion. Accordingly Article 6(1) did not apply to the process.
the Article refers to proceedings before a "tribunal", which the Court has defined in largely traditional terms as a body exercising an independent adjudicative role.\textsuperscript{263} The Court has also affirmed that Article 6(1) is concerned with disputes which are "at least on arguable grounds, to be recognised under domestic law."\textsuperscript{264} Similarly investigative functions, such as those carried out by inspectors appointed under the UK Companies Act 1985 to inquire into the affairs of a company, were not adjudicative in nature and the findings of those inspectors were not legally dispositive of the petitioner's rights, so that Article 6 was held not to be applicable to such an investigation.\textsuperscript{265}

While there is a theoretical possibility of Article 6(1) being used to promote the rights of participants in regulatory processes, the above discussion shows that the prospects here may be limited. The European Court of Human Rights has been reluctant to extend the scope of the Article beyond adjudicative or quasi-judicial acts of administrative tribunals. The scope of application of Article 6(1) to rule making or policy setting activities of regulatory tribunals is therefore doubtful. Similarly the existence of a potential domestic remedy of judicial review and the need for a 'live' dispute are further limiting factors. Despite a promising basis in theory, using Article 6(1) of the ECHR to promote consultation and participation rights in the processes of economic regulation unfortunately appears more problematic in practice.

8.4.4 Summary

The above considerations highlight the difficulties inherent in introducing APA-type procedures either through the common law or by reliance on fundamental constitutional or human rights. As a matter of principle, all such forms of non-statutory implication

\textsuperscript{263.} See \textit{Benthem v The Netherlands} (1985) 8 EHRR 1 at 11: "...by the word 'tribunal', it denotes 'bodies which exhibit...common fundamental features', of which the most important are independence and impartiality, and 'the guarantees of judicial procedure'." A similarly restrictive approach was taken in \textit{Zumtobel v Austria} (1993) 17 EHRR 134.

\textsuperscript{264.} See for example \textit{Bryan v United Kingdom} (1995) 21 EHRR 342 (existence of domestic remedy of judicial review of planning authority's demolition notice was sufficient to oust the operation of Article 6(1) of the Convention).

\textsuperscript{265.} \textit{Fayed v United Kingdom} (1994) 18 EHRR 393.
also suffer from the problem that their consistency of application depends not only on
the views of individual judges (which often differ considerably) but also on prevailing
attitudes to the use of such methods. The case of *Bates v Lord Hailsham*, discussed
above, illustrates that some judges will be less than adventurous in seeking to imply
consultation requirements in the absence of clear statutory authority although the
evolving doctrine of legitimate expectation affords greater scope for optimism in this
area.

Recent history has also shown that the Executive in the United Kingdom has been more
than willing to disregard codes of practice or similar instruments which are not
embodied in statutory form when such a course seems to be expedient. Birkinshaw has
pointed out that the history of government flirtations with Official Information
procedures in the UK provides examples of such policy reversals. In more recent
times we have witnessed the former Deputy Prime Minister, Mr Heseltine, stating
publicly that Britain would consider withdrawing its recognition of the jurisdiction of
the European Court of Human Rights in Strasbourg following that court's judgment in
September 1995 concerning the shooting of three IRA members by the SAS in
Gibraltar. These considerations suggest that statutory enactment represents the
optimal, if not the only, solution to the problem. This issue will now be addressed.

8.4.5 A Specific Statutory Enactment in the United Kingdom

(i) Features of the US Approach

This part of the chapter gives free rein to the luxury reserved to academic writers of
discussing on the theoretical benefits of an APA-style statute in the United Kingdom
without having to consider the rather more vexed issue of whether the legislative will
exists to tackle such a project. Indeed, all the indications from the empirical research

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266. See the text accompanying notes 21-23, supra.

267. See Birkinshaw, "I only ask for information' - The White Paper on open government" [1993]
Pub Law 557, drawing attention (at 557) to the actions of the incoming Thatcher administration
in disregarding the *Croham Directive on Open Government* (Civil Service Department, 6 July
1977).

268. See article in *The Times*, 27 September 1995: "Government upset at European Court decision".
undertaken for this thesis are that the legislative will to effect such a reform probably does not exist at present, and may well not exist in Britain for some time to come. It goes without saying, in the present writer's view, that this attitude is unfortunate, and one which hopefully the present work and others like it may play a modest part in helping to change. It is first instructive to consider the advantages which have been claimed for the US legislation. These have been the subject of extensive comment by US academic writers and a discussion of the principal arguments now follows.

One of the best treatments of the merits of the APA in recent times is that of Professor Freedman, in his book on the US administrative process,269 who pointed to the fact that one of the greatest achievements of the Administrative Procedure Act lay in its role in incorporating concepts of fairness and due process into the administrative process.270 Freedman pointed to the standardising influence of the Act, especially following the turbulent period of the New Deal, as being one of the major factors serving to allay concerns about the constitutional legitimacy of the administrative agencies. The insistence of the Act on minimum standards of procedural fairness and due process furthered the promotion of these constitutional values.

Furthermore the availability of standard administrative procedures served to provide a consistent basis for judicial review of administrative action in the US courts, avoiding a jurisprudence which might otherwise have been much more disjointed and inconsistent. Freedman considered that the success of the Act was reflected, as much as anything, in the fact that its first major amendment by Congress did not occur until 1966, and even this was simply to incorporate requirements derived from the newly introduced Freedom of Information Act rather than to make any substantial changes to the procedural regime contained in the legislation.


270. Ibid at pp 130-131: "The generality of the Act's major requirements has been a significant reason for its success in achieving a useful measure of procedural uniformity among agencies with very different regulatory responsibilities. It has been this generality of conception that has permitted judicial decisions applying the Act's provisions to one agency to temper and enrich decisions applying the same provisions to other agencies. This achievement indicates why the Act is properly regarded as one of the most important developments in administrative law in the twentieth century."
It is certainly difficult to overestimate the contribution which the APA has made to US administrative procedure. Indeed, its role as a benchmark for agency action and in providing a basis for the application of judicial review techniques in a consistent manner, constitute major achievements in themselves. Another aspect which is worthy of mention is the express identification and separation in the Act of rule making and adjudication functions and the differing procedural requirements applicable to each of these processes.\footnote{271} It should also be remembered that all of this was achieved in an Act which was originally only 12 sections in length. These admirable qualities of the Act have been recognised by the US courts, dating back to the first decision of the US Supreme Court interpreting the Act itself, where the court noted that one of the principal purposes of the Act was to exert a standardising influence.\footnote{272}

Lest the above comments be taken to have blinded the writer to some of the less desirable aspects of the Act, some attention should be directed to these also. One of the obvious deficiencies in the US statutory scheme is that the application of the Act, in terms of its detailed procedural requirements for public hearings, is confined to formal or “on the record” rule making activities and adjudicatory hearings, rather than informal administrative processes, where the requirements are more straightforward.\footnote{273} Furthermore the ability of agencies to utilise rule making techniques which fall within the exceptions to the “notice and comment procedures”, such as interpretative rules and policy guidance, has also been noted previously.\footnote{274}

However, perhaps the greatest difficulty facing the continued acceptance of the APA in its present form is not the problems set out above, but the issue of whether or not the procedures in the Act are adequate to reflect existing agency procedures and policies.

\footnote{271}{See the discussion in Freedman, \textit{supra} note 269, chapter 10.}

\footnote{272}{\textit{Wong Yang Sung v McGrath} 339 US 33 at 41 (1950): "...[The APA was designed] to introduce greater uniformity of procedure and standardization of administrative practice among the diverse agencies whose customs had departed so widely from each other."}

\footnote{273}{See the discussion of this point in part 6.4.2(iii) of chapter 6. See also Breger, "The APA: An Administrative Conference Perspective" (1986) 72 Virg LR 337 at 349: "Unless Congress can devise an effective statutory threshold that distinguishes the rules that require only the notice and comment process from those that demand more elaborate procedures, statutory revision may only hamper the efficiency and quality of administrative decisionmaking."}

\footnote{274}{See the discussion in part 6.4.2(iv) of chapter 6.
The problem of rule making ossification and its causes have been the subject of more detailed discussion in chapter 6. Agencies have sought to counter this situation by the use of other devices, including consensual procedures involving negotiated rule making under the auspices of the Negotiated Rule Making Act 1990, which were also discussed in more detail in that chapter.

A perceptible difficulty with existing techniques of economic regulation, both in the United States and the United Kingdom, has been that they have tended to focus unduly on issues of institutional design rather than on issues of process. While regulatory processes admittedly need to operate within a defined institutional structure of some kind, the best designed institutions in the world will not prevail in the face of obsolete, inadequate or inappropriate processes. To some extent this is one of the major failings which might be laid at the door of the US system of economic regulation, although it must be added in mitigation that steps have been taken in the United States to address these problems. Most notably, suggested solutions to the problems of rule making ossification, involving consensual and negotiated procedures, may yet prove to be the salvation of the US regulatory process.

(ii) The UK Context

In seeking to apply these lessons in the UK context, some consideration needs to be given to the ways in which a statutory regime dealing with consultation and could be modified to render it more suitable (or acceptable!) in the UK context. Consideration of this issue reveals that the following matters would need to be addressed:

(a) The scope of application of any general statute would need to be determined with some care. The traditional problem which arises here is the need to balance procedural fairness with administrative efficiency. In other words generalised participation and consultation requirements ought not to be so extensive as to stultify the regulatory process altogether. Having said this, it

275. See the discussion in part 6.5 of chapter 6.
276. See the discussion of negotiated rule making techniques in part 6.6.3 of chapter 6.
should be recognised that wide exceptions, such as those at present contained in the US APA, are necessarily conducive to good administration in the regulatory area.

(b) The distinction preserved in the US statute between formal and informal rule making may not necessarily be entirely appropriate in UK circumstances. Formal or "on the record" rule making involving public hearing procedures does of course presuppose the existence of a suitable structure within which such hearings can take place. A whole new infrastructure, involving separate hearing officers (or administrative law judges as they have come to be known in US practice), support staff and facilities would be necessary. A record of the agency decision and deliberations would need to be prepared. While the writer personally supports such procedures as part of the democratic process in this area, they are clearly not without cost. They would also need to be implemented at a time in which the costs of government are subject to far closer scrutiny than they were in previous times. The adoption of modified APA type procedures in the UK need not necessarily involve fully-fledged hearing procedures. The essential feature of such legislation should be the ensuring of consistency of approach across the whole range of administrative and regulatory actions.

(c) The above considerations lead to the third point, which is that the US distinction between formal and informal rule making, a distinction which itself is derived from the terms of individual regulatory statutes, means that any general APA type statute would need to be correlated with existing legislation in the regulatory area. If some forms of administrative rule making are to require public hearings then express provision for these would need to be incorporated in individual regulatory statutes. There are some UK statutes, such as the Civil Aviation Act 1982 and the Social Security Administration Act 1992, which contain their own adjudication procedures and these would need to be harmonised with any generalised statutory approach.

(d) Issues of institutional design also need to be addressed. The US legislation is based on a system of independent regulatory commissions which are
nevertheless subject to Congressional funding controls, Presidential oversight
and extensive judicial supervision by way of judicial review. Not all of these
structures or their equivalents are present in UK economic regulation. In
some cases none are. The implications of these differences need to be
explored.

The above issues clearly raise policy questions of great difficulty. Equally though, it
can be argued that the foreseeable benefits tend to outweigh these problems.
Considerable progress has undoubtedly been made by individual industry regulators in
recent years in implementing improved consultation and participation procedures, and
in developing appropriate hearing and adjudication procedures where necessary.
However, the danger is that without a structured legislative basis such procedures are
not guaranteed to evolve, or even to survive, in the longer term.

If an era of savage government cost-cutting and indifference to regulatory issues, or a
perceived need for greater expedition in regulatory decisions, should occur in the future
(and such trends in public administration are by no means unprecedented) then many of
the advances made to date may be the first to be abandoned in such a climate.\textsuperscript{277}
While the present discussion does not claim to provide all of the answers to the above
policy dilemmas, the issues are ones that need to be confronted. In the following
section, some suggestions as to a possible way forward will be advanced.

\section*{8.5 Some Issues Arising from the Possible Adoption of a Statutory Approach}

\subsection*{8.5.1 Introduction}

The preceding parts of this chapter have considered some mechanisms for introducing
public consultation and participation requirements in a structured fashion, along with
related issues such as the appropriate intensity of judicial review. This part examines

\textsuperscript{277.} UK regulation has of course recently witnessed the unedifying spectacle of the Director General
of OFLOT, Mr Peter Davis, compromising his independence by accepting free flights and
hospitality from the US lottery company G-Tech on the professed justification that this course
would save the British taxpayer the money which would otherwise have been expended by the
regulator on such activities. For a discussion of the OFLOT situation see part 7.2.1 of chapter 7.
some modifications to the US regulatory model which might be desirable in the UK context and also some practical issues which would need to be addressed.

8.5.2 The Use of Consensual Procedures

To begin with the processes for regulatory decision making, it has been seen that US practice is moving increasingly in the direction of consensual procedures such as negotiated rule making, more colloquially known as "Reg-Neg". Under the Negotiated Rule Making Act 1990278 a detailed procedure for negotiated rule making has been put in place.279 The 1990 Act evidences considerable thought by Congress concerning the suitability of proposed rules for the process of negotiated rule making.

The Act, in §563, sets out seven criteria for an agency to apply when determining whether to embark on the negotiated rule making procedure in any particular case. These criteria include whether there are a limited number of identifiable interests that will be significantly affected by the rule, the likelihood that those interests can be adequately represented on a rule making committee and whether there is a reasonable likelihood that the committee will reach a consensus on the proposed rule within a fixed period. If the criteria in the Act can be fulfilled then the agency can appoint a rule making committee, engage the services of convenors and facilitators if necessary, and then proceed with the negotiated rule making process. It is noteworthy that no agency action relating to the establishment and activities of a negotiated rule making committee can be subject to judicial review under the 1990 Act.280

278. 5 USC 101-648.

279. For a discussion of the background to this legislation see part 6.6.3 of chapter 6. The current state of negotiated rule making in the United States is described in Pritzker and Dalton, Negotiated Rulemaking Source Book (Office of the Chairman, ACUS, Washington DC, September 1995); Rogers, Building Consensus in Agency Rulemaking: Implementing the Negotiated Rulemaking Act (ACUS, Washington DC, October 1995). I am grateful to Mr Gary J Edles, former General Counsel to the ACUS prior to its dissolution by Congress on 31 October 1995, for providing me with a copy of these and other useful ACUS publications on the federal administrative process. I should also express my appreciation to Professor Cosmo Graham of the Law Faculty, University of Hull, for providing me with contact details for the ACUS during discussions with him in October 1995.

280. See §570 of the Negotiated Rulemaking Act 1990.
US experience has shown that negotiated rule making procedures are likely to be most successful where the parties affected by the proposed rule are willing to negotiate meaningfully with a view to finalising the rules in question. This is less likely to occur where the affected parties perceive the proposed regulatory action as being directly opposed to their core business philosophy or where such parties strongly oppose the rules in question or any conceivable modifications to them. In the US system, of course, there is a greater incentive to agree on the form of proposed rules as otherwise the APA procedures, if pursued to a final conclusion, can eventually result in rules being adopted whether the affected parties desire this outcome or not.

In UK economic regulation, particularly in the utilities area where an incumbent monopolist may wish to delay a proposed regulatory initiative, the scope for the use of such consensual procedures may be correspondingly reduced. The recent contretemps between OFTEL and BT over proposed licence amendments aimed at giving the Director General of Telecommunications a broad discretion to attack anti-competitive practices by a licensee provides a case in point. This case study will be considered in more detail in the following chapter.

Negotiated rule making also requires some degree of commitment in terms of funding and resources, at least in the short term, as the Administrative Conference of the United States has noted. For the technique to be successful the agency needs to ensure as far as possible that all interest groups and affected parties are represented during the negotiation process. Some thought also has to be given to the composition of the negotiation committee. As well as persons with specific expertise in the particular area, other members of the committee who have skills in dispute resolution techniques have been found to be indispensable to the process. Formal procedures for liaison between the regulatory body and the negotiation committee have generally also been adopted in the case of US negotiated rule making procedures.

281. See Negotiated Rulemaking Source Book, supra note 279, p 5: "Negotiated rule making can be resource-intensive in the short term for both the agency and the other affected interests. While there are likely to be significant long-term savings in total resources required, the concentration in the short term may cause concern. For the agency, there will be extra expenditures just to conduct the reg-neg process including costs of the convenor and mediator. In addition, the compression of the rule making schedule may require the agency to allocate staff and technical contractor resources for use over a shorter period of time than in rulemakings not involving reg-neg. The agency would also have to assign a senior manager to sit at the negotiating table."
Although formal regulatory negotiation is a relatively recent development in US practice it has grown rapidly in popularity and has been adopted by a number of regulatory agencies. These include the EPA, the Occupational Safety and Health Administration and the Federal Aviation Administration.

In the context of UK regulation there have been some examples of regulators holding relatively informal discussions with regulated interests over the terms of licences and franchises. One noteworthy example is the approval process instituted by the Rail Regulator in relation to conditions of track access agreements, a procedure which will be discussed in further detail in the following chapter. However a genuine commitment to the widespread use of transparent consensual procedures in UK regulation would require both structural and attitudinal changes to the existing regulatory regimes. Professor Prosser has noted that negotiation and bargaining techniques in the UK regulatory context, while not uncommon, have tended in the past to be ad hoc and unstructured.

While a separate statutory framework along the US lines might not be essential it would certainly be useful. There would also need to be considerable input of resources


284. Ibid, pp 250-255.

285. See Graham and Prosser, supra note 25, p 230: "There are, of course, no procedural limitations on how those negotiations are to be conducted: the negotiations are not overseen nor approved by an independent body; there are simply minimal notice and comment requirements. The literature on corporatism...provides evidence that this form of decision-making is not peculiar to the sphere of privatized enterprises but can be found in all sectors. There are, however, no systematic attempts to provide legal structuring to this process. The American materials indicate that the resources are there; what is lacking in Britain is a realization that such forms of decision-making do raise legal and constitutional issues." See also Lewis and Harden, "Privatisation, De-Regulation and Constitutionality: Some Anglo-American Comparisons" (1983) 34 NILQ 207, 212-214; Jowell, "Bargaining in Development Control", [1977] Jnl Planning Law 414; Daintith, "The Executive Power Today" in Jowell and Oliver (eds), The Changing Constitution (Clarendon Press, Oxford, 1985), pp 186-194.
into establishing negotiation committees and a system of convenors and facilitators to implement any negotiation-based processes. Such developments would appear to be some way off in the UK context, but they certainly merit further investigation.

Another approach, which is also worthy of examination, is the use of some form of arbitration or mediation procedure. Procedures of this kind might be particularly useful in relation to matters such as interconnection or access disputes. As was discussed earlier, the use of arbitration procedures has been recommended in New Zealand in the case of access and interconnection disputes arising in the telecommunications industry and the interconnection agreement concluded in May 1996 between the two major industry participants includes detailed dispute resolution procedures. These initiatives will be discussed further in Chapter 11.

For such methods to function effectively, considerable thought would need to be given to issues of institutional design. In particular the question arises as to how the arbitration authority would be constituted - should it be a government body or involve independent private arbitrators? In the latter event particular care would need to be taken to avoid conflicts of interest arising.

Such consensual procedures clearly merit further investigation. They need not necessarily be accompanied by a reduction in transparency. Indeed both negotiation and arbitration procedures could either be conducted in public or could involve participation by representatives of the public and of special interest groups. The use of such procedures would serve to avoid the need for lengthy and cumbersome appeal procedures involving the MMC and would conceivably also obviate the need for parties to the process to challenge regulatory decisions by judicial review. However, it seems at this point that such developments in the UK are still some way in the future.

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286. See the discussion in part 4.6.4 of chapter 4.

287. See the discussion in part 11.5.2 of chapter 11.
8.5.3 Extent of Consultation and Participation Procedures

It was seen earlier in this chapter that the extent to which consultation and participation procedures should be adopted in relation to regulatory decision making remains a live issue. The approach preferred in this chapter would be to expose as many regulatory procedures as possible to public scrutiny and involvement. A common procedure, through a general APA type statute, would assist in standardising existing statutory requirements and would put economic regulation of different areas of the UK economy on an equal footing.

At present the proliferation of regulatory bodies and Directors-General can lead to inconsistency of approach and lack of policy direction on an industry wide basis. With the advent of the super-utility, in the form of the United Utilities combined water, electricity and telecommunications utility company which commenced operations on 1 January 1996, the need for co-ordinated industry policies has become more cogent.288 Some commentators, such as Helm, have advocated some degree of rationalisation of the regulatory bodies.289

Helm has also pointed to some of the advantages which in his view would flow from the use of common methodologies in the regulatory area, including greater certainty of operation, savings in cost, reduced scope for regulatory disputes and greater efficiency

288. See article in The Times, 30 December 1995: "Tighter rein on utilities."

289. Helm, supra note 180, p 159: "There is a strong case for single-sector regulators for transport, energy and communications. Such broader bodies would, of course, retain experts in each of the particular industries but the overall responsibility for regulation would necessarily be co-ordinated. The administrative costs of regulation would also be considerably reduced by the avoidance of duplication." In similar vein see Landau, "The Future Regulation of Broadcasting and Telecommunications in the United Kingdom" (1997) 4 CTLR 145: "If such a system of regulation [for broadcasting and telecommunications] is to be transparent and accountable to the public and to Parliament, there is a strong argument to suggest that a single statutory regulator for communication is the most appropriate means by which these criteria can be satisfied." This call for unified regulation in the UK broadcasting and telecommunications area mirrors current US regulatory policy as contained in the Telecommunications Act 1996, in which the catchword is "convergence". For a discussion of these developments see Price and Duffy, "Technological Change and Doctrinal Persistence: Telecommunications Reform in Congress and the Court" (1997) 97 Col LR 976 at 983: "In the floor discussions of the new legislation, it was commonplace to hear that a vision of 'the convergence of these technologies' lay at 'the heart of this reform effort'... as a result, many in Congress believed that historic divisions, artificially supported by legislative distinctions and federal and state bureaucratic arrangements, needed to be dissolved."
of operation. Veljanovski has taken a similar view, arguing that the existing economic regulators should be reduced to three, an Office of Communications (incorporating OFTEL, ITC, the Radio Authority and the Broadcasting Standards Council), an Office of Energy Regulation (consisting of OFGAS, OFFER and the Gas Consumer Council) and an Office of Transport Regulation (including the CAA and the two rail transport regulators). Labour Party spokespersons, such as Peter Hain, argued when in Opposition in favour of a single utilities commission to replace the existing industry regulators.

While these arguments have some force, consensus in this area is not universal. Professor Graham has argued, for example, that mergers of regulatory bodies may not automatically improve decision making or accountability. However, it is distinctly arguable that these outcomes would be promoted by the adoption of standardised techniques, which would in turn flow from the adoption of an APA type statute.

8.5.4 Issues of Institutional Design

At present, economic regulation in Britain is carried on through two principal institutional structures, the regulatory commission and the system of single industry regulators. The former structure is in evidence in bodies such as the Civil Aviation Authority and the Independent Television Commission. The latter structure is present in the regulatory arrangements relating to the privatised utilities, including rail transport. In the US regulatory context, the independent regulatory commissions are the predominant structure which has long been in existence. Single industry regulators


291. Veljanovski, supra note 123, p 83.

292. Hain, supra note 104, p 15. As at the close of 1995 the concept of a unified utilities commission, at least in relation to the energy sector, still appears to represent Labour Party policy. See articles in The Times, 2 January 1996: "Labour puts energy into power reform" and "Labour may merge utility watchdogs." Mr John Battle, the Shadow Minister for Energy, is reported in these articles as favouring the concept of a single energy regulator with a panel of advisers and adequate backup support.

in the form of individuals are not favoured, although constitutional reasons have a great deal to do with this situation.

Given that in the United Kingdom industries collectively representing some 20% of GDP are under the control of single individuals of limited accountability, the desirability of this situation has been queried from time to time. While both types of regulatory structure seem to be able to function passably well in practice in UK experience, the use of the former, commission type of structure in economic regulation seems preferable for the reasons which are canvassed below.

In practice, the single industry regulators effectively function in a corporate form, in that their offices are divided into various departments or divisions and the regulators themselves are assisted by advisory committees. OFTEL has recently given some consideration to its internal structures in terms of giving advisory committees a more formal role in the regulatory process. BT suggested, in the course of consultation during the early part of 1995 over interconnection and competition policy in the telecommunications industry, that an advisory committee of suitably qualified business and professional persons could be set up to advise the Director General on policy implementation. In its July 1995 statement on competition policy in the industry

294. OFGAS, for example, is divided into three policy directorates, a Network Code Directorate and a Regulation and Business Affairs Directorate. (Information supplied to the writer by Mr Kyran Hanks of OFGAS in the course of an interview on 15 November 1995.) OFTEL is divided into a number of branches, the principal ones being the five policy sections, Branch 1 (Network Competition), Branch 2 (Consumer Policy), Branch 3 (Licensing Policy), Branch 4 (Fair Trading Policy) and Branch 10 (Services, Competition and International Affairs). (Information supplied to the writer by Mr David Chalfen of OFTEL during an interview on 6 December 1995.) The Office of the Rail Regulator is divided into four directorates, Network Regulation, Passenger Services Regulation, Legal, and Administration. (Information supplied to the writer by Mr Michael Brocklehurst, Chief Legal Adviser to the ORR, during an interview on 17 November 1995.)

295. In the case of the ORR, for example, a general advisory group is made up of the head of each of the four directorates and holds regular policy meetings with the Rail Regulator where outside consultants are present. In November 1995 these included a transport consultant and a representative from London Underground. (Information supplied to the writer by Mr Michael Brocklehurst, Chief Legal Adviser to the ORR during an interview on 17 November 1995.)
OFTEL invited submissions on the desirability of establishing such a committee\textsuperscript{296} and has expressed its own views on the issue.\textsuperscript{297}

Some commentators take the view that there is little difference in practice between a single regulator and a commission structure, especially where the single regulator is advised by an advisory committee.\textsuperscript{298} Professor Graham, for example, has argued that the only result of a commission structure might be to slow down regulatory decision making without necessarily improving efficiency or accountability.\textsuperscript{299}

It is true, as Professor Graham has pointed out, that decision making by commissions in the UK has not been free from difficulty. Problems with the MMC procedure have already been discussed above. The ITC has also not been without its critics, some of whom have alleged that the Commission members have been unduly swayed by the


\textsuperscript{297} Ibid, para 6.39: "The Director General has power to set up advisory committees under the Telecommunications Act. Legally such a committee could only advise, it could not bind the Director General, although in practice, however, its views would necessarily carry considerable weight. If good people prepared to spare the necessary time could be identified, a committee to advise on competition issues and complaints could provide valuable independent and professional input into the regulatory process."

\textsuperscript{298} See for example Winsor, "Privatisation and Utilities Regulation - The Case for Reform" (paper presented at the AIC Conference,\textit{ Regulation and the Regulators}, London, 3 November 1995) at p 10: "It is not true to say that single-person regulation is defective in as much as the regulator cannot cope on his or her own. Each of the sectoral regulators has a committee of the most senior officials of the organisation. That committee advises the regulator on the decisions to be taken, and is a forum for high-level analysis and discussion of issues before a decision is taken. It is much more like the panel approach than many people suppose." (The writer notes in passing that Mr Winsor is a partner in the City law firm which advises the Rail Regulator and has spent some time on secondment with the ORR.)

\textsuperscript{299} Graham,\textit{ supra} note 293, pp 44-45: "Commission decision taking will inevitably tend towards a greater degree of compromise and consensus than decisions by a single individual. If this is the case it may not lead to better decision making. Although there are virtues in consensus decision making there are also dangers. It is unclear that the idea of regulatory commissions would lead to better decision making. The EOC has been criticised quite severely over the years for the lack of a strategy, IBA and ITC decision making has also been castigated and it is a common complaint amongst competition lawyers that the decisions of the MMC are inconsistent. None of these examples suggest that the commission approach automatically produces better decisions, or indeed more accountable ones, although there are other variables in play here."
ITC Chief Executive, David Glencross, who was reputed to exert a strong influence over Commission decisions.\(^\text{300}\)

While, other things being equal, the two regulatory structures may both serve the purpose, at the theoretical level a commission structure has certain discernible advantages. The argument which equates the merits of the two structures may be somewhat analogous to asserting that Brighton and the Bahamas are equally desirable holiday destinations without specifying the season of the year in which one wishes to go on holiday. Like holiday destinations, regulatory structures may have to function equally well in mid-winter as well as in mid-summer. UK economic regulation has perhaps been fortunate to date in its choice of single-industry regulators. It has in general avoided the egomaniac, the megalomaniac and those who are simply corrupt, dishonest or incompetent. However the recent unfortunate events at OFLOT demonstrate that such a situation may not continue indefinitely. In the end the system’s luck may well run out.

At least in the case of a commission structure there is increased scope for diluting the idiosyncrasies of an individual chairperson, even one with a dominant personality. Furthermore the old adage that “two heads are better than one” may apply here also, especially where a regulator consisting of a single individual has wide discretionary powers and is not obliged to accept the recommendations of senior officials or an advisory committee. Similarly, when the issue of overt or covert political interference rears its head, it is again conceivably more difficult to influence a whole commission as opposed to an individual. The same argument applies to issues of regulatory capture. While the commission structure is by no means perfect, in the longer term it may well prove to be preferable to the alternative.

It is perhaps noteworthy that in the much criticised area of regulation of financial services, some recent proposals for reform have focused on a suggested system of twin

\(^\text{300}\). See article by Leapman in the *Independent on Sunday*, 6 November 1995, “Who’s Watching Television?”: “Many believe that the most influential voice [in relation to ITC decision making] is that of the Senior Staff Officer, chief executive David Glencross, a veteran of the BBC in its paternalist days before the Britain revolution. A zealous advocate of public service broadcasting, Glencross is forever on the lookout for backsliding by the ITV companies. His fingerprints were all over the commission’s unyielding insistence on the inviolability of the News at Ten’s weekday time-slot against encroachment by anything except live football. Last year he came down firmly against a plan to move the news permanently.”
financial regulators, incorporating a financial stability commission and a consumer protection commission in place of the present two tier system. It is also not without significance that the retiring Director General of Telecommunications, Mr Don Cruickshank, recently expressed his preference for a commission structure for OFTEL.\textsuperscript{301} However no one has yet advocated the adoption of single individuals as regulators in place of a commission structure in the financial services area, or indeed (so far as the writer is aware) in any other field at present regulated by a commission structure in Britain. As we have seen, however, the reverse arguments have been raised by various commentators.

From an institutional perspective, there seems to be no reason why the suggestions for reform outlined above could not be implemented through either form of regulatory structure. However, the other considerations discussed above, taken on balance, tend to favour the commission structure in the context of UK economic regulation.

8.6 Summary

This chapter has considered the central importance of consultation and participation requirements in the regulatory area. It has looked at attempts to impose such requirements by common law, by administrative practice and by statute in a variety of jurisdictions. The discussion in part 8.2 of this chapter has compared the use of these techniques in Australia and Canada and has sought to highlight the arguments in favour of a statutory scheme. It is interesting to note that the legislation in force in Victoria and Quebec draws heavily on US experience with the Administrative Procedure Act. In the UK discussion has centred more on the possible form which a general statute might take.

The chapter has also looked at the common law experience with prescribing consultation and participation requirements, beginning with discouraging precedents such as the \textit{Bates} case and moving on to more promising avenues, such as the

\textsuperscript{301} In relation to financial services see \textit{Twin Peaks: A regulatory structure for the new century} (Centre for the Study of Financial Innovation, London, December 1995). For reference to Mr Cruickshank's views as to the desirability of adopting a commission structure for OFTEL see article in \textit{The Times}, 24 September 1997: "Telecom regulator decides to quit".
expanding scope of the doctrine of legitimate expectation. This analysis has centred on the role of judicial review and its application in Britain to decisions by economic regulators. The limitations of this remedy and the desirable intensity of judicial review in the area of agency decision making were also examined in detail.

The shortcomings of relying on common law remedies in this area have also been discussed above, with emphasis on jurisdictions such as Canada and New Zealand which have adopted a codified bill of rights in statutory form. In the UK context, the influence of jurisprudence based on Article 6 of the European Convention for the Protection of Human Rights and Fundamental Freedoms has also been examined. Here, as with the Canadian and New Zealand enactments in this area, the problem centres on the limited ambit of the fundamental rights which can be invoked in this area, as well as the reluctance of some (though not all) judges to take an active role in this area.

Nevertheless, as the chapter has noted, there is scope for enterprising judicial activism to promote worthwhile progress in the attainment of these goals. It may be that in due course the ECHR and the ECJ will come to interpret the European Convention on Human Rights and its associated jurisprudence as giving rise to a general right to consultation and participation in the decision making processes of economic regulators. Such a development would be desirable. If fairness of procedure is to be extended to judicial and quasi-judicial processes then it is not too great a leap from there to applying such concepts to the area of economic regulation.

Finally the chapter has considered the desirable extent of consultation and participation procedures and has related this issue to the corresponding issue of institutional design in the regulatory area. This part of the discussion has served to focus attention on the attributes of differing regulatory structures and their relationship to the attainment of regulatory regimes embodying desired levels of consultation and participation. In particular the US distinction between rule making and adjudication in economic regulation would require some modification before such a regime could be introduced into the UK scene. As always, the significance of differing economic, social and political factors needs to be taken into account, although these are not necessarily as insuperable as some commentators suggest.
The general aim of this chapter has been to demonstrate the desirability of procedures which encourage consultation and participation in the context of UK economic regulation and to suggest ways of encouraging their implementation in practice. The arguments in this chapter should be seen as central to the development of the general proposition advanced in this thesis that external economic regulation only attains its essential legitimacy by reason of a legislative and administrative context which has regard to the goals discussed in this chapter. Unfortunately the typical experience of the United Kingdom and other Commonwealth jurisdictions has been that the attainment of these goals in the context of the process of economic regulation is still some way off. The following chapter deals with some UK case studies with the aim of reinforcing the arguments developed in this chapter and in earlier chapters by reference to some concrete examples.
9. CASE STUDIES IN UK ECONOMIC REGULATION

9.1 Introduction

The previous chapter examined some of the theoretical considerations underlying the use of more extensive consultation and participation techniques in the context of economic regulation in Britain. This chapter deals with some case studies drawn from current UK regulatory practice. It begins with an examination of the consultation regimes now being employed by the utility regulators and then moves on to look at consultation and hearing procedures and issues of regulatory design in four specific areas of contemporary UK economic regulation. These are: the approval process for track access agreements which has been adopted by the Rail Regulator; ITC consultation procedures; the regime of CAA public hearings in respect of air transport licensing applications and finally the mix between rules and discretion in the design of regulatory provisions, as reflected in the new fair trading condition in BT's telecommunications licence.

These four areas have been selected for more detailed scrutiny in this chapter as they represent some current regulatory initiatives of respects which are illustrative of the argument in this thesis. They also tend to reflect corresponding issues under the US regulatory system, namely the "notice and comment" procedure, the use of formal adjudication and public hearing procedures and issues in the design of regulatory rules. In addition they deal with matters such as the choice of hearing officers for adjudication processes, the involvement of third parties and intervenors in the regulatory process and the use of appeals and judicial review procedures. The case studies in this chapter highlight some of the similarities and differences between the UK and US regulatory regimes. The chapter also comments on the possible effects which the adoption of US APA style procedures might have on existing UK practice under the particular regulatory regimes to be discussed.
9.2 Consultation Procedures Adopted by the Utility Regulators

9.2.1 The Move Towards Transparency

As has been noted in previous chapters, the UK utility regulators have, over the past two to three years, been pursuing increasingly transparent procedures in the course of their regulatory activities. The four major utility regulators, OFGAS, OFWAT, OFFER and OFTEL, have each issued a number of consultation papers from time to time inviting submissions on particular policies under consideration.

To take the example of OFGAS, these consultation papers have covered a broad range of policy areas in gas industry regulation. As was discussed in chapter 7, the Director General of Gas Supply has expressed a preference for submissions to be in a form which can be made publicly available to interested parties in the OFGAS library. The topics covered in the course of consultation have included pricing structures and price controls for gas transportation and storage, considerations arising from the separation of the transportation and storage activities of British Gas and the liabilities payable by British Gas TransCo in relation to the Network Code. As will be discussed further in chapter 11, consumer organisations such as the National Consumer Council have frequently participated in the consultation process by lodging submissions with the regulator.

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1. See the discussion in parts 7.4 and 7.6 of chapter 7 and part 8.3 of chapter 8.

2. See part 8.3.2(iv) of chapter 8.

3. For the titles of a number of these consultation documents see the footnotes in part 8.3.2(iii) of chapter 8.

9.2.2 OFTEL Consultation Procedures

(i) Introduction

The consultation procedures adopted by OFTEL merit further discussion as OFTEL has tended to lead the way among the utility regulators in this area. Its own view of progress in this area up to June 1994 was set out in its Annual Report of that year.5

Consultation by OFTEL has covered a range of topics. These have included interconnection and accounting separation, effective competition and interconnection policy, the role of service providers and the provision of universal telecommunications services in the United Kingdom.6 Public participation in the OFTEL consultation process has been encouraged by press releases, major press conferences and meetings with consumer and interest groups.7

(ii) The Involvement of Industry Groups in the OFTEL Consultation Process

OFTEL has been concerned to involve as many telecommunications operators in the consultative process as possible. This desire led in the early part of 1993 to the formation of an Other Licensed Operators (OLO) Group, comprised of the other UK telecommunications operators apart from BT.8 The OLO Group was initially a loose and fairly informal federation. However, since its formation it has adopted increasingly structured procedures and now has some 18-20 members.

5. See OFTEL 1994 Annual Report (HMSO, London), paragraph 1.16: "How open and transparent is OFTEL and the regulatory regime? Clearly we have to turn the spotlight on ourselves. We have made good progress during 1994 on several fronts. We continued our dialogue with the industry through a series of very useful workshops and meetings, and cross industry working groups. We also published more explanatory documents giving the reasoning behind our regulatory decisions."

6. For a list of OFTEL publications during 1994, for example, see the OFTEL 1994 Annual Report, ibid, Table 9 at pages 70-71.

7. See the OFTEL 1994 Annual Report, supra note 5, paragraph 8.2.

8. I am grateful to Mr Paul Chisholm, President of Colt Telecommunications and the first Chairman of the OLO, for providing me with a good deal of helpful information on the activities of this group during an interview with him at his offices in London on 5 December 1995.
The impetus for the formation of the group arose from the concerns of telecommunications operators planning to enter the UK market, particularly some of the major US telecommunications companies. Many of these companies perceived difficulties with the regulatory regime and in particular with the lack of tangible proposals for a feasible interconnection regime. Some of the incoming operators were concerned, if not more than a little dismayed, at the comparative lack of workable proposals in this area. These operators decided to form a single consultative group, initially with the object of presenting a single voice to OFTEL on consultative procedures. The founding members of OLO were Mercury Communications, Scottish Telecom, AT & T, Colt Telecommunications, Sprint, Telstra, ACC and Nynex. Other cable companies and resellers have joined the group subsequently.

The group initiated a series of consultations with OFTEL, particularly in relation to interconnection procedures. Over time the telecommunications industry increasingly came to be represented, in its discussions with OFTEL, by BT on the one hand and by the OLO representatives on the other. While BT was initially somewhat dismissive of the group, it gradually recognised the desirability of trying to work with the OLO on many regulatory issues. Such an approach sprang partly from self-interest, in the recognition that regulatory procedures might be expedited if areas of disagreement between BT and other users could be minimised or resolved in advance. BT also came to recognise that, although it enjoyed dominant market power in the industry and its commercial interests did not necessarily coincide with those of the newer market entrants, there might also be areas in which the licensed operators would benefit from presenting a united front to OFTEL.

The OLO Group has involved itself in the various OFTEL consultations. It has presented collective submissions on behalf of its members and has also worked closely with OFTEL staff in areas such as the setting of interconnection policy. It became apparent to OLO representatives at a comparatively early stage that BT itself engaged in extensive lobbying with OFTEL on a range of issues. The OLO felt that comparable involvement on its own part would serve to redress any imbalances of this kind.
In addition, the OLO has had considerable input into the design of the proposed anti-competitive licence condition put forward by the regulator.\(^9\) Its support for such an approach derived in no small measure from the experiences of many individual OLO members, who believed they had encountered systematic opposition from BT in a number of areas, particularly in relation to interconnection procedures. Many members considered that such activities either bordered on, or directly constituted, anti-competitive behaviour on the part of BT. OLO members were also more than a little frustrated by the apparent inability of OFTEL to relate such conduct to breaches of specific conditions in the BT licence. They recognised that it would assist in proving the systemic nature of such activities if they were in a position to compare experiences in a more structured fashion.

The founding chairman of the OLO, Mr Paul Chisholm of COLT Telecommunications, detailed some areas of regulatory reform which the OLO was interested in pursuing during an interview in the course of research for this thesis.\(^10\) A number of the founding OLO members were US telecommunications companies which had first hand experience of the American regulatory regime. While they did not necessarily support fully-fledged public hearing procedures and the associated "paper war", they were similarly disenchanted with some of the perceived limitations of the UK regulatory system. These included a perception that the regulatory regime was perhaps susceptible, at least in its earlier stages, to undue influence from a market leader such as BT, and that the legislative framework in the Telecommunications Act conferred insufficient powers on the Director General to address issues such as anti-competitive behaviour on the part of the dominant licensee. (OLO members also recognised, in relation to the latter point, that this was not a failing restricted to the Telecommunications Act, but was symptomatic of the need for more effective competition legislation in the United Kingdom.)

In terms of structural changes, the OLO was generally in favour of investing the Director General of Telecommunications with wider discretionary powers to tackle anti-competitive conduct. The perception was that such an approach might serve to

\(^9\) See the discussion of this proposed condition in parts 8.6 and 8.7 of this chapter.

\(^10\) See note 8, supra.
compensate for the lack of a stronger competition law, at least in the short to medium term. The group also favoured the use of an independent hearing officer at OFTEL to assess and consider regulatory disputes. Apart from these institutional changes the OLO considered that, in the longer term, one of the most effective ways of managing an incumbent monopolist such as BT was by public relations and media pressure.

Mr Chisholm considered that the involvement of the OLO in the regulatory process had been beneficial to OFTEL and its staff, in that it had helped OFTEL appreciate the concerns of the other users apart from BT. It had also served to demonstrate the effectiveness of the consultative processes which the Director General of Telecommunications had adopted. This view was shared by Mr John Bean, Head of Interconnection Policy at OFTEL, who thought that the OLO had played a valuable role in the consultative process.

Mr Bean also pointed to the fact that the involvement of industry groups such as the OLO served to streamline industry consultations by reducing the number of individual parties participating in the process. He confirmed that this had made the task of issuing consultation documents and position papers, following various industry workshops, more manageable. The ability of the OLO to formulate an agreed position with its members had also expedited what might have been a very cumbersome process.

In general OFTEL has tended to lead the way among the utility regulators in terms of transparency of procedures. This is further illustrated by its pioneering use of public regulatory hearings, a development which will be discussed further later in this chapter.

(iii) The Adoption of a Structured Consultation Process

During 1995 OFTEL refined and formalised its consultation procedures by way of a statement issued in March of that year. This statement dealt with OFTEL procedures

11. Interview with Mr John Bean of OFTEL on 21 November 1995.

12. See Statement issued by the Director General of Telecommunications, Consultation Procedures and Transparency (OFTEL, 21 March 1995). I am grateful to Professor Tony Prosser of the Faculty of Law, University of Glasgow, for first bringing this document to my attention. This statement supplements the procedures that are set out in the publication Doing Business with OFTEL (OFTEL, London, 3 February 1995), paragraphs 3.11 - 3.24.
for formal and informal consultations. Under the adopted procedures responses to consultations were to be held in the OFTEL library and made available for perusal. OFTEL expressed a preference for confidential parts of such responses to be kept to a minimum. In appropriate cases an edited version of the response, with the confidential parts removed, would be placed in the OFTEL library. The Director General warned that he reserved the right to publish information which was materially significant despite a claim to confidentiality, and that he might elect to give less weight to confidential responses to informal public consultations, as other industry participants would not have had the opportunity of commenting on such responses.

Formal consultations have to be accompanied, under the 1984 Act, by a minimum period of 28 days within which representations can be made. OFTEL, in its March 1995 statement, noted that such a system allowed little opportunity for participants to comment on submissions received from other parties and proposed a two stage consultation process.

The practical operation of this two stage process has been illustrated by recent OFTEL consultations. For example, in its consultation document on universal service provision in the United Kingdom from 1997 onwards, issued on 6 December 1995, OFTEL provided for an initial consultation period lasting until 29 February 1996. This was followed by a further 14 day period lasting until 14 March 1996, in which comments could be made on any submissions lodged with OFTEL during the first stage of the

13. The Director General of Telecommunications has statutory power to do this in appropriate cases under s 48 of the Telecommunications Act 1984. For a more detailed discussion of OFTEL's approach in this area see Doing Business with OFTEL, ibid, paragraphs 3.40 - 3.41.


15. See OFTEL Statement, supra note 12, paragraph 5: "OFTEL therefore proposes, subject to feedback from interested parties, for all future consultations where this is practical and would not lead to unwarranted delay, to incorporate a second consultation stage during which the Director General would be prepared to receive comments on other parties' submissions. This period, which would normally be of 14 days, would start immediately after the first stage and would allow parties to make representations having had the opportunity to consider the 'first stage' representations made available in the OFTEL library. OFTEL will set out the relevant timeframes in public consultation documents. OFTEL hopes that this 'period for review' will assist objective analysis of the formal submissions."
consultation. The statement of March 1995 reinforced OFTEL's stated commitment to provide reasons for its regulatory decisions. Such reasons could include reference to submissions lodged with OFTEL, including a summary of any confidential submissions.

The current OFTEL consultation regime has been well designed and the two stage process, allowing an opportunity for parties to comment on earlier submissions, seems preferable to comparable regimes in other jurisdictions, including the 'notice and comment' procedures under the US APA and the single stage consultation regime proposed in Australia by the Report of the Administrative Review Council. The 14 day period allowed under the second stage of the process may, however, prove to be rather tight if a lengthy submission is received by OFTEL on the last day of the first stage of any particular consultation, although the industry participants are no doubt sufficiently well resourced to accommodate such a timetable. It will be of interest to monitor experience with the two stage consultation structure in the future.

9.2.3 Evaluation of the Consultation Procedures Adopted by the Privatised Utilities

The individual utility regulators have clearly gone to considerable lengths to encourage participation in the regulatory process, with OFTEL playing a leading role in these initiatives. The practical position in the United Kingdom in relation to the privatised utilities therefore mirrors, to some extent, the 'notice and comment' approach to rulemaking under the US APA in this area. Reservations can be entertained about whether a voluntary commitment to consultation regimes by individual regulators, however genuine this may be, can ever fully supplant a formal statutory regime. Possibilities such as changes in political fashion, the vagaries of funding and the spectre

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17. The commitment to issuing reasoned decisions was first set out formally in Doing Business with OFTEL, supra note 12, paragraphs 5.20 - 5.23.


19. See part 6.4 of chapter 6 on the US APA and part 8.2.2.(iv) of chapter 8 on the ARC Report.
of government interference in the regulatory process were the subject of discussion in a previous chapter.20

These possible difficulties may of course be more illusory than real in the case of the utility regulators. The Directors-General operate with a reasonably high degree of independence and their activities are self-funding, their costs being covered by the regulated industries themselves. It would be almost unthinkable for the utility regulators to now seek to introduce a more restrictive consultation regime at this stage and any such attempt would certainly attract strong adverse criticism. There might well be scope for argument that existing regulatory practice was such as to give rise to a legitimate expectation of future consultation, as was discussed in part 8.2.2(iii) of the previous chapter. For the present therefore, the system appears to be functioning adequately in practice, and the OFTEL initiatives, in particular, are commendable in their scope and implementation.

9.3 Consultation and Hearing Initiatives Introduced by the Rail Regulator

9.3.1 Consultation Initiatives

In common with the utility regulators, the Rail Regulator has issued a number of consultation documents, and has expressed the view that clear explanations of policy and wide consultation are important objectives of the regulatory process in relation to rail transport.21 To date these consultation documents have covered issues such as through ticket sales, track access charges and other matters.22 The Rail Regulator's paper on rail ticketing, which suggested that through ticket sales should be restricted to

20. See part 8.4.4 of chapter 8.

21. See Report of the Rail Regulator to the Secretary of State for Transport (Office of the Rail Regulator, London, July 1995), Regulator's statement, p 5, paragraph 3(ii), where the regulator lists various objectives including "to explain clearly what the 'public interest' criteria are which inform our decisions", "to consult widely before taking important 'public interest' decisions" and "to cooperate with others charged with the performance of statutory duties, including the Secretary of State, the Franchising Director, and the Rail Users' Committees."

22. See part 7.6.1(ii) of chapter 7. A list of ORR publications can be found in the 1995 ORR Annual Report, ibid, p 63.
a limited number of core stations, attracted a good deal of comment, and no small amount of controversy, as was noted in chapter 7.23

The Rail Regulator regards education of licensees as an important enforcement tool. He has for example spoken to several rail companies in relation to the highly topical issue of discriminatory ticket sales, where an intending rail traveller is not advised by the ticketing clerk of a better value ticket available on the same route from a competing operator. However he has also made it plain to rail franchisees that he would be prepared to consider stronger enforcement measures where voluntary compliance was not forthcoming.24

9.3.2 Requirements for Track Access Agreements

This part of the chapter focuses on a particular aspect of the procedures adopted by the Rail Regulator in fulfilling his statutory responsibilities, namely the mechanism for approval of track access agreements. Under the Railways Act 1993, the Rail Regulator has the task of giving directions to a facility owner requiring it to enter into an access contract with an applicant for the use of those facilities.25 (In practice the facility owner will normally be Railtrack.) Where the facility owner enters into an access contract pursuant to such directions, the Regulator must approve the terms of the contract.26 The access contracts for which approval is required are those of the kind specified in s 18(2) of the Act, including contracts for the use of track, stations and light maintenance depots.

23. See part 7.6.1(ii) of chapter 7.

24. Information supplied to the writer by Mr Michael Brocklehurst, Chief Legal Adviser at the Office of the Rail Regulator, during a lengthy interview with him at his office on 17 November 1995. See also the discussion in part 4.3.4 of chapter 4 of the stricter enforcement regime proposed by the Rail Regulator in June 1997.

25. Railways Act 1993, s 17(1).

26. Ibid s 18 (1). For a general discussion of the regulator's responsibilities in relation to track access agreements see Dallas, "Railways: Regulatory Aspects of Track Access Agreements" (1994) 5 Util LR 159.
The regulator issued a policy document in September 1994 setting out the principles to be followed in relation to approval of track access agreements. A second edition of this document was subsequently released in March 1995. This document set out in some detail the principles which the Rail Regulator expected to adopt in relation to the approval of track access agreements for passenger operations using Railtrack's network, pursuant to the Regulator's obligations under s 18 of the 1993 Act.

In the Approval Criteria, the Regulator emphasised that his decisions were to be made within the framework of s 4 of the Act, which set out his general duties. In clause 13 of the document the Regulator stated that he would expect to be satisfied that Railtrack had properly checked the timetabling detail of the proposed agreement to ensure there was no conflict with existing access contracts. (Railtrack has retained the responsibility for ensuring there is no overselling of track capacity, and approval by the Rail Regulator under s 18 is not a guarantee that track capacity is available.) The Rail Regulator would however seek appropriate assurances and information from Railtrack in this area when considering an application under s 17.

Interestingly, under clause 14 of the Approval Criteria, the Regulator has adopted the standard practice of requiring Railtrack to satisfy him that appropriate formal consultation and user research has been carried out. This process is to be properly documented for perusal by the Regulator.


28. Ibid, clause 13 of the 2nd edition of the Approval Criteria, which provides: "The Regulator will expect to be satisfied that Railtrack has carried out proper checks to ensure that the proposed agreement does not conflict with any pre-existing access contract (whether regulated or not). However, responsibility for ensuring that track capacity is not oversold rests with Railtrack. Regulatory approval of an agreement under section 18 does not constitute a guarantee that the capacity exists and it is essentially a matter for train operators what measure of assurance they obtain from Railtrack. In that respect, the Regulator may require documented evidence of consultation with other users. Clearly, in considering a section 17 application, the Regulator will need to consider and evaluate whether capacity exists, seeking assurances and information from Railtrack as he considers appropriate."

29. Ibid, clause 14 of the 2nd edition of the Approval Criteria, which provides: "The Regulator will also normally require Railtrack to satisfy him that it has carried out appropriate formal consultation and research among other users and potential users of the route to establish what are their reasonable aspirations for future access rights and whether the proposed agreement conflicts with these aspirations. This process should be documented and auditable."
The Approval Criteria also specified that related documents needed to be submitted to the Regulator along with the agreement.\(^{30}\) Operators could prevent modifications to track access conditions taking effect where these materially prevented a train operator exercising or receiving the benefits of a protected right under the Track Access Conditions or where they materially increased a protected obligation.\(^{31}\) The Regulator has also expressed a desire to ensure that the effect which an agreement had on track capacity was clearly stated and that provisions allowing for capacity to be increased were framed in specific terms, clearly setting out matters such as the scope of the increase.\(^{32}\)

The level of charges levied by Railtrack to franchised operators has been the subject of a policy statement by the Regulator.\(^{33}\) The main components of the charging policy were as follows. First, charges for the 1995-96 year should show an overall reduction in real terms of 8% compared with the previous year. Secondly, individual track access charges ought to fall by 2% a year in real terms from the 1996-97 year, reflecting the reduced level of Railtrack's costs. Thirdly, variations in net income away from the levels projected by Railtrack were to be shared between Railtrack and the passenger service regulators. Finally, access charges were to be further reviewed in the year 2000, with the outcome to be reflected in access agreements from 1 April 2001.

Similar approval criteria have been issued in relation to freight track access agreements relating to freight operators.\(^{34}\) In the case of rail freight operators, the criteria for approval of the access agreements were analogous in many respects to those pertaining to the passenger area. However, there were specific requirements relating to applications for directions under s 17 of the Act and the approval process under s 18.

\(^{30}\) Ibid clause 18.

\(^{31}\) Ibid clauses 23 and 24.

\(^{32}\) Ibid clause 37.


In the case of the approval process under s 18, the Regulator envisaged a time scale for approval of about eight weeks from the date of submission of the agreement and supporting information.35 Upon receipt of the application an official from the ORR's office was appointed to liaise with the applicant. The completeness of the information submitted by the applicant would then be checked. A decision would be made at this point by the Regulator as to whether or not consultation with other users would be required. Such consultation was normally necessary where the Regulator formed the view that the interests of other parties might be materially affected if approval of the application was granted.36

Submissions received from any parties to the consultation process were then considered and further consultation might be undertaken if required. Further questions could be directed to the parties and, depending on the outcome of this process, approval would either be granted for the application or formal discussions would be held with the parties if "significant regulatory issues" were involved.37 The agreement would then be approved, either without modification or subject to modification, or rejected.38

9.3.3 Procedures for Approving Track Access Agreements

For the approval of passenger track access agreements under s 18 of the Act the Rail Regulator has, quite commendably, developed a structured approval process aimed at ensuring both that the criteria in the legislation are met and also that passenger rail service operators are fully acquainted with their contractual and statutory responsibilities. A description of the process adopted by the Rail Regulator in this area now follows.39

37. Ibid clause 79.
38. In the case of rejection of the agreement, clause 81(c) of the Approval Criteria provides that: "The Regulator will notify the parties to the agreement, and may, in his discretion, give reasons for his decision."
39. I am indebted to Mr Michael Brocklehurst, Chief Legal Adviser to the Rail Regulator, for providing me with a good deal of helpful information on this process, together with copies of a
The approval procedure reflected the concern which the Rail Regulator, as an experienced barrister, had with ensuring that issues of transparency and due process were observed in relation to applicants. The procedures also reflected the ORR's general regulatory approach, which emphasised the importance of educating and properly informing operators as an important enforcement tool.

The process for approval of passenger track access agreements consists of a private hearing before the Regulator. The parties to the hearing comprise representatives of the prospective operator and of Railtrack. The Office of Passenger Rail Franchising is also represented. Other interested operators who have participated in the consultation process may also attend. The Regulator is usually assisted by the Chief Legal Adviser or a member of the ORR's legal department and other officials from the ORR as required. The parties attending the hearing may be represented by counsel but as the Regulator's interest is mainly focused on matters such as timetabling requirements and co-ordination of passenger services, legal representation is often regarded as being unnecessary by many applicants, unless particularly contentious issues are likely to arise.

Prior to the hearing a detailed written questionnaire is sent to the applicant and this document, together with the answers received, are made available to the other parties, including operators who may be affected by the proposed service. At the hearing itself the Rail Regulator seeks to understand exactly what the applicant is seeking to achieve in terms of its application. The applicant's ideas are clarified and developed and any areas of confusion or misunderstanding existing between Railtrack and the operator are clarified.

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40. In his 1995 Annual Report, supra note 21, the Rail Regulator stated in paragraph 32 of his Regulator's Statement: "Third, as a result of the establishment of appropriate resources and a commitment to due process at all times I have, I hope, contributed to a better understanding of 'regulatory risk' in the restructured railway industry. Reasonable and pragmatic decisions taken by an independent Regulator in the pursuit of statutory objectives are more effective if they are seen to flow from decision-making criteria put in the public domain for debate and comment."

41. The Rail Regulator described the hearing process in his 1995 Annual Report, supra note 21, in the following terms at p 22, paragraph 46: "These hearings allow the Regulator to ask questions of the parties to a contract in the presence of consultees - other operators whose services are
The form of the hearing is similar in some respects to what might be adopted in the case of a private arbitration. The parties are seated in separate positions before the Regulator and a stenographer takes a transcript of the proceedings. However, the parties do not give sworn evidence. The procedures are largely consensual in nature and generally consist of dialogue between the Regulator and his staff, the OPRAF representative and the parties. The Regulator is principally concerned with ensuring that the operator has thought through the actual mechanics of the proposed passenger service and has the necessary degree of managerial and organisational competence to operate the service to an acceptable standard. There is power under s17 of the Act for a formal application for directions to be made in cases where agreement between the applicant and Railtrack on conditions of track access cannot be reached, but so far such an eventuality has not arisen.

Approval hearings commenced in July 1994 and as of November 1995 some 23 hearings had been completed. There is a prospect that additional hearings might be required if existing operators were to seek extended or modified access rights but examples of this have so far not arisen. A similar regime is likely in respect of freight access agreements but the approval process for freight access agreements is still at a comparatively early stage of development.

If the applicant is not satisfied with the outcome of the approval process then an application for directions under s17(1) is possible but so far such a situation has not presented itself. There is also the possibility of judicial review of a Regulator's decision under s18. Such an application might be most likely to arise where the application was rejected or unacceptable modifications were sought to be imposed on the applicant. However the consultation procedures adopted by the ORR, combined with the hearing procedure described above, have so far served to ensure that major areas of dispute are minimised or eliminated before the Regulator's final decision is made.

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affected by the terms of the proposed contract and those responsible for providing financial support for services, for example representatives of affected Passenger Transport Executives (PTEs). Prior to the hearings detailed written questions to the parties are sent out. These, and the answers received, are made available to consultees, who are also given the opportunity to make representations. Those present at hearings are always encouraged to comment on any aspect of the process and the Regulator provides written reasons for his decisions."
The above procedures provide an illustration of welcome innovation by a UK economic regulator. While s 18(1) of the Railways Act merely provides for the Regulator to approve the terms of access contracts, without setting out any details of the procedure to be adopted, the Regulator has, of his own accord, adopted a structured process aimed at ensuring that any areas of concern or uncertainty are addressed before approval is given. Such a procedure has also enabled the Regulator to be satisfied that the interests of all parties have been catered for and that the statutory criteria defining the Regulator's mandate have been complied with. Hopefully the end result of such a progressive procedure will be to ensure that operators have a better understanding of their statutory and contractual responsibilities and areas of ambiguity or confusion are resolved.

The approval process also demonstrates the usefulness of consensual, as opposed to adversarial, regulatory procedures in appropriate circumstances. In the case of track access agreements, the parties are submitting for regulatory approval a document which records their pre-existing agreement on the applicable issues. The regulatory tribunal is therefore not required to adjudicate on a live dispute where the interests of the parties may be totally divergent and consensus is unlikely to be achieved. (This is often the case, for example, in areas such as CAA route licensing hearings, where the applicant for a particular licence may be strongly opposed at the hearing by objectors such as competing airlines. The subject of CAA hearings will be explored further in part 9.5 of this chapter.)

When approving track access agreements the Rail Regulator is primarily concerned with satisfying himself that the agreement already reached between Railtrack and the operator is acceptable from a regulatory standpoint and with ensuring that the operator is aware of the obligations which it is assuming. To this extent the use of a consensual procedure reflects the experience with similar procedures, such as negotiated rulemaking techniques in the United States, which have been perceived to work best when there is no great diversity of approach on the part of the participants in the process.42 The approval procedure does, however, differ from a true mediation in that the Rail Regulator has statutory authority to impose an ultimate outcome on the parties.

42. See the discussion of US negotiated rulemaking in part 6.6.3 of chapter 6.
notwithstanding their individual preferences. In general, the approval process for track access agreements serves to illustrate that regulatory regimes based on approval of franchising contracts can lend themselves to the use of consensual procedures in appropriate cases.

9.4 Consultation Procedures Adopted by the Independent Television Commission

9.4.1 Statutory Consultation Requirements

Along with the Civil Aviation Authority, the Independent Television Commission (ITC) is the other principal example of a UK regulatory authority having a commission structure and operating in the economic area. As was noted in the previous chapter, the ITC was the successor body to the Independent Broadcasting Authority (IBA). Under the Broadcasting Act 1990, the ITC has general jurisdiction in respect of the award of television licences and the regulation of UK commercial television services. This role has involved it in several judicial review applications, as was also noted in chapter 8.

This part of the chapter focuses on the consultative procedures adopted by the ITC in the course of fulfilling its statutory responsibilities. Various provisions of the Broadcasting Act 1990 impose specific consultative requirements on the ITC. First, in relation to variations in television licence conditions, the Commission has power to

43. See the discussion in part 8.3.5(ii) of chapter 8.

44. For a general discussion of the regulatory functions of the ITC see Prosser, "Public Service Broadcasting and Deregulation in the UK" (1992) 7 Eur. J. Comm. 173; Barendt, Broadcasting Law. A Comparative Study (Clarendon Press, Oxford, 1993), chapters 4 and 5; ITC Notes (Information Office, Independent Television Commission, London), particularly Nos 1 (ITC - Introduction), 3 (Broadcasting Act 1990), 5 (Licensing Procedures), 6 (Regulation), 16 (Channel 3 (ITV)), 29 (Channel 4), 30 (Channel 5), 48 (Viewer Consultative Councils). The regulatory responsibilities of the ITC traverse both economic and social policy in relation to television broadcasting, ranging from the awarding of television licences to matters concerning the content of television programmes.

45. See the discussion in part 8.3.5(ii) of chapter 8.

46. I am grateful for the assistance afforded to me by Sarah Thane, Director of Public Affairs for the Independent Television Commission, during an interview with me at the offices of the ITC in London on 22 November 1995.
vary licences on notice if the licence holder consents or, alternatively, where the licence holder "has been given a reasonable opportunity of making representations to the Commission about the variations." 47

Under s 9(1) of the 1990 Act the Commission is required to prepare a code governing advertising standards and practice and issues of programme sponsorship. This is to be done "after the appropriate consultation", which is defined in subsection (2) as meaning consultation with the Radio Authority, licence holders, representatives of viewers, advertisers and qualified professional organisations and with "such other bodies or persons who are concerned with standards of conduct in advertising as the Commission think fit."

9.4.2 ITC Consultation in Practice

In practice the ITC has consulted widely in relation to proposed code changes, and has placed considerable emphasis on transparent decision-making procedures. Such consultation has included reference to public interest groups such as the Voice of Listeners and Viewers and the Mothers' Union together with national consumer organisations such as the National Consumer Council. In addition the Commission has also consulted with existing licensees, independent television producers and organisations with a direct interest in commercial television. 48

The Commission has drawn assistance in this area from an Advertising Advisory Committee (AAC) which meets quarterly and which includes representatives of consumer and advertising interests as well as other individual members with particular expertise in this area. The Committee has reviewed the Code of Advertising Standards and Practice and made appropriate recommendations to the ITC, both in relation to the Code and on sponsorship matters. The AAC has recently carried out work in relation

47. Broadcasting Act 1990, s 3(4).

48. Information provided to the writer by Sarah Thane of ITC during my interview with her, supra note 46.
to standards for food advertising, particularly in relation to children, and the advertising of slimming products and homeopathic medicines.49

Consultation has also been undertaken in relation to various topics of interest to consumers of television services. This accords with the Commission's general duties under s 2(2) of the 1990 Act to ensure that a wide range of television services is available throughout the United Kingdom and that fair and effective competition is present in relation to the provision of such services. The Commission must also ensure under this provision that television programme services are licensed in a manner best calculated to ensure "the provision of such services which (taken as a whole) are of high quality and offer a wide range of programmes calculated to appeal to a variety of tastes and interests."

The ITC undertook consultation during 1993 in relation to issues such as frequency planning for digital television.50 On this issue, persons wishing to make submissions on the discussion document issued at the end of June 1993 were allowed a period of three months until the end of September 1993 in which to do so. Notes of Preliminary Results issued by the ITC on 13 September 1993 were designed to facilitate the making of submissions on the June discussion document.

Another, more recent, area of consultation has been in relation to the ITC's proposed Code of Conduct in relation to conditional access and ancillary services.51 Submissions on the proposed draft Code were required to be made within a two month period, by 8 December 1995. The draft Code reflected the ITC's statutory responsibility to ensure fair and effective competition in relation to licensed television services. Its publication followed increasing concern about existing and potential difficulties in gaining access to television broadcast services and the need to ensure


compatibility of operation in the industry as a whole. (One major area of concern, for example, was the need to avoid consumers having to purchase a variety of different satellite dishes or other forms of receiving apparatus in order to access different television services.  

9.4.3 Consultation on the Issuing of Television Licences

Consultation has also been undertaken in relation to the licensing of television services. In relation to Channel 3, a consultative paper was issued by the Office of Fair Trading in August 1992 on networking arrangements for the service, dealing with the issue of whether or not adequate competition was present. The regional Channel 3 licensees disputed the OFT's conclusion that the competition test was not satisfied and the matter was then referred to the MMC for further investigation. An MMC report was issued in April 1993 which recommended various modifications to the networking proposals. Revised networking arrangements, incorporating the MMC's suggested revisions, were published in September 1993 following ITC approval.

The issuing of Channel 3 licences was itself carried out with some degree of transparency under the applicable statutory provisions. Following the closing date for applications for the Channel 3 licence, the Commission was required to publish the name of every applicant, the proposals submitted by the applicant and other appropriate information, together with a notice inviting representations in relation to these matters and specifying the manner and time for making such representations.

So far as the Channel 5 television licence is concerned, the 1990 Act set out the obligation of the Commission to "do all that they can to secure the provision of a television broadcasting service... known as Channel 5." While ss 28-30 of the 1990 Act conferred a wide discretion on the Commission in relation to the issuing of the

52. For a discussion of some of these aspects see ITC 1994 Annual Report, supra note 49, pp 36-41.
53. For a summary of these events see ITC Notes, supra note 44, No 17, "Channel 3 Networking Arrangement."
54. See Broadcasting Act 1990, s15(6)(a) and (b).
Channel 5 licence and did not specify any particular consultation requirements as being necessary, the Commission nevertheless undertook extensive consultation in relation to the proposed service.

Initially, the embryonic ITC (which was not formally constituted until 1 January 1991) invited expressions of interest during September 1990 in relation to the proposed Channel 5 service. In November 1991 the ITC issued a draft invitation to apply and this document was refined and amended in the light of comments received on the draft. A formal invitation to apply was issued on 14 April 1992. Only one application, from Channel Five Holdings Limited, was received, but the Commission was not satisfied with the business plan submitted or with the investment proposals suggested and it announced that it would review the available options.

Further consultation took place during 1993 and 1994. In September 1994 the ITC decided to readvertise the Channel 5 licence. A formal invitation to apply was distributed on 1 November 1994. The closing date for submissions was set as 2 May 1995. The subsequent award of the Channel 5 licence to Channel 5 Broadcasting Limited on 27 October 1995 and the ensuing judicial review application have been described earlier in chapter 8.

The Commission is also required under s 12 of the 1990 Act to make arrangements for ascertaining the state of public opinion concerning programmes included in licensed services and the effects of such programmes on attitudes and behaviour. It has undertaken an annual survey in satisfaction of this requirement, involving a quota sample of about 1,000 adult persons who are interviewed in their homes. The results of data from recent surveys are lodged with the ESRC Data Archive at the University of Essex and are available to genuine researchers. An annual summary of the survey

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58. See part 8.3.5(ii)(b) of chapter 8; *ITC Press Release 78/95, "ITC Announces its Decision to Award Channel 5 Licence"* (ITC, London, 27 October 1995).
results is published by the ITC. The 1994 summary of survey results, for example, contains a wide ranging analysis of a number of aspects of television services.59

9.4.4 Summary

As in the case of rail regulation, the ITC has shown a commendable level of commitment to transparent procedures and an active consultative approach. There have been some areas, particularly in relation to financial matters and the identity of prospective staff (a matter of obvious sensitivity in a relatively confined employment market such as the television industry), where licence applicants have sought confidentiality from the Commission and information has been kept confidential in appropriate cases. In practice confidentiality is ensured by arranging for the confidential parts of a licence application to be bound and lodged separately with the ITC. These confidential documents are kept in locked storage at the ITC offices under restricted access. However the general ethos of the ITC is to publish documents as widely as possible.60 ITC documentation and responses to consultations are available in the ITC's library, which is open daily to researchers and other interested parties and copies of ITC publications are available from the Commission's offices.

While the ITC has been the subject of criticism in some quarters for its allegedly bureaucratic and top heavy commission structure,61 it appears to function reasonably efficiently in practice and its emphasis on transparency and the use of consultative procedures in the course of its regulatory activities is to be welcomed in the area of UK economic regulation. This is particularly the case given that the ITC's approach to

59. See Television: The Public's View 1994 (ITC Research Publication, London, 1994). Two of the more fascinating responses to the 1994 survey (at least to this writer) are as follows: (at p26) "I would find it easy to live without TV" - response by terrestrial subscribers - agree 42%, disagree 57%; satellite/cable subscribers - agree 39%, disagree 61%; (at p27) "I often sit down and see two or more movies in succession when watching a movie channel" - agree 41%, disagree 53%, (a response which indicates to the writer that at least 41% of the population appear to have more leisure time than him). If nothing else, the results of such surveys do serve to indicate the pervasive power of television as a modern communications and entertainment medium.

60. In my interview with Sarah Thane, supra note 46, she advised that her general view on this issue was that ITC staff had to demonstrate to her satisfaction why any ITC documentation should be withheld from publication in any particular case.

61. See part 8.5.4 of chapter 8.
consultation and public participation exceeds its statutory obligations in a number of instances.

9.5 Hearing Procedures Adopted by the Civil Aviation Authority

9.5.1 Experience with the Use of Formal Hearing Procedures in UK Regulation

The structure and functions of the Civil Aviation Authority (CAA) were described in chapter 7. The CAA is unique in contemporary UK economic regulation in having put in place a structured form of hearing procedure involving fairly traditional adversarial procedures to determine the allocation of route licences in the civil aviation context. As was noted above, the Rail Regulator has instituted an approval process for track access agreements which has some of the attributes of a judicial hearing but which does not involve cross examination of witnesses or extensive participation by counsel and is in fact largely consensual in nature.

Part 9.6 of this chapter describes the OFTEL public hearing, held in November 1995, which was the first of its kind undertaken by the UK utility regulators. Again this hearing was more in the nature of a public symposium, with the opportunity for persons attending to direct questions and comments to panel members representing different interest groups in the industry, together with some academic commentators.

In other fields, such as that of social legislation, adjudicative techniques have been more widely employed. There is, for example, a well developed system of adjudication of claims for social security benefits in the United Kingdom. This system involves initial adjudication in local offices with internal reviews and appeals and the possibility of a further right of appeal to a Social Security Appeal Tribunal. The nature of the hearing process in this area has undergone a change in emphasis in recent years from an

62. See part 7.6.2 of chapter 7.

adversarial to an inquisitorial approach, although this has not always been apparent in practice. Indeed, the present system of adjudication in social security matters has been criticised by commentators on various grounds.

These include the fact that members of existing social security adjudication tribunals are thought to be uncomfortable with the increasing use of inquisitorial procedures by appeal tribunals, unrepresented appellants may be at a disadvantage when appearing before the tribunals and the fact that departmental presenting officers may be prone to adopting an aggressively adversarial stance at hearings, rather than seeking to assist the tribunal to reach a fair decision. John Baldwin and his co-authors have summarised their perceptions of the shortcomings of the current system of social security adjudication.

In the area of economic regulation, different considerations may apply. Where the parties are more evenly matched and have access to competent legal representation, the disadvantages flowing from the adoption of adversarial procedures in the context of a formal hearing are less pronounced. However, the CAA is the only economic regulator which has so far adopted a formal process of adjudication involving truly judicial hearing procedures along the lines of the public hearing regime under the US APA. Some aspects of the CAA hearing regime will now be examined.

64. Baldwin et al, ibid, pp 151-153.

65. Baldwin et al, supra note 63, chapter 6; Logie and Watchman, supra note 63, pp 126-128.

66. See Genn and Genn, The Effectiveness of Representation at Tribunals (Lord Chancellor's Department, London, 1989), p 161; Baldwin et al, supra note 63, chapter 7.

67. Baldwin et al, supra note 63, pp 211-212: "This changed nature of adjudication has fundamental consequences for the various actors involved. We have seen in several chapters of this book how unrealistic expectations and tensions have been generated for them. Not all legal chairmen, for instance, naturally play an inquisitorial role expected of them; lay members have signally failed to adapt to the new regime based on law instead of paternalism; and presenting officers are ill-suited to be amici curiae and for the most part adopt feeble alternative roles. The concepts which have been promoted in the 1980s, in part as a reaction to the acknowledged inadequacies of the old system, fit awkwardly into the reformed nature of social security adjudication. Moreover, the attempt to graft inquisitorial elements on to an essentially adversarial process has served to mask the need for a greater availability of advice and representation services for the claimant. Neither the inquisitorial efforts of chairmen at hearings nor the best intentions of presenting officers can adequately redress the scales for unrepresented appellants."
9.5.2 CAA Hearing Procedures

This part of the chapter outlines some aspects of the CAA hearing procedures, beginning with rights of objection. As was noted in chapter 7, the effect of the EC Single Market and the emphasis on deregulation in European air travel has diminished the significance of the hearing procedures in recent years. However they still merit analysis here as an example of an adjudicative regulatory technique.

Under the 1991 regulations interested parties have a right to object and make representations in relation to licence applications.68 Objectors are not entitled to be heard unless they serve an objection in terms of the regulations and have status under clause 25(1) of the regulations. This clause generally requires the objector to be the holder of an air transport licence, an air transport operator's certificate or an aerodrome licence. The regulations specify a time limit for serving objections on the CAA.69

The procedure prior to and at the hearing reflects typical practice for adversarial proceedings.70 Written submissions are required from the applicant a minimum of 25 working days prior to the hearing and failure to provide them gives rise to the risk of an adjournment. The objectors deliver their written submissions at least 10 working days prior to the hearing. In general the applicant's submissions will address the need for the proposed service, the reasons why the applicant is best qualified to provide that service and evidence as to the impact of the service on existing carriers. The applicant has the burden of satisfying the CAA on these matters. Evidence from economists, travel agents, specialists in the particular tourist market, financial witnesses and other expert witnesses is often necessary. In addition, an applicant will generally find it necessary to lead some statistical evidence relating to traffic patterns, market forecasts and similar matters.

The Authority will also be concerned to satisfy itself that the applicant is in a satisfactory financial position to provide the service, bearing in mind that new air

68. See Civil Aviation Regulations 1991, cl 20(1), 25(1).
70. Detailed hearing and pre-hearing procedures are set out in the CAA Official Record (Series 1, Section 9), entitled "Hearings and Decisions of the Authority."
services frequently take some time to become profitable. Written advice from the Department of Transport on any impact which the proposed service might have on existing bilateral arrangements may also be necessary. Evidence concerning the applicant's flight timetable, fares tariff and pricing structure will be required. The factual evidence needs to be produced through a witness from the applicant who will preferably be someone who has personal knowledge of the proposed service. The name of the witness must be notified to the CAA at least two working days prior to the hearing together with the name and status of the persons representing the applicant and any other parties to the hearing. Such a representative need not be legally qualified and several in-house airline representatives have developed considerable expertise in this area.

The hearing itself is conducted before a panel composed of two CAA board members, one of whom is the chairman. An advisor sits with the panel. This is normally a CAA official from the licensing division who is in a position to advise the panel on matters arising in the course of the hearing. (The Group Director of Economic Regulation at the CAA normally fulfills this role.) There is also a secretary to the panel. The regulations confer a broad discretion on the CAA in terms of procedure at the hearing, allowing the CAA to basically conduct the hearing as it thinks fit. At the hearing parties may adduce oral or written evidence and may examine other parties and witnesses.

Hearings are less formal than those of a court of law but the hearing procedure is essentially the same. The applicant normally presents opening submissions and then leads evidence through its witnesses, who may be cross-examined and re-examined. Other parties such as objectors then present their cases and finally the parties can present closing submissions. Hearings are in public unless the CAA decides otherwise. The public may be excluded where part of the hearing involves evidence of confidential

71. For a general description of the procedures prior to and at the hearing, see Blackshaw, supra note 69, chapters 10 and 11; 1991 Regulations supra note 68, clauses 25-26. I am also grateful to Mr Peter Stanton, Senior Policy Officer, Economic Regulation Group of the CAA, for providing me with much useful information on the practical functioning of the hearing regime during an interview with me in London on 17 November 1995. See also part 7.6.2 of chapter 7.
bilateral treaties or other matters which are commercially sensitive or subject to the Official Secrets Act.\textsuperscript{72}

The proceedings at hearings are recorded and the tapes are transcribed into a written transcript which can be made available for purchase from the CAA. After the hearing has concluded a decision in writing is given. This may take anything from several weeks to several months depending on the Authority's workload at the time.

Following the decision there is a right of appeal to the Secretary of State. This is exercised by way of written submissions and the Secretary of State may refer particular matters to the Authority or to the parties for explanation or clarification before issuing a final decision.\textsuperscript{73} There is also the possibility of judicial review of any of these decisions, although the last occasion on which such a course was pursued in relation to the CAA was the Skytrain litigation in 1977.\textsuperscript{74}

9.5.3 Evaluation of the CAA Hearing Regime

Despite its declining significance in recent years, the CAA public hearing procedure appears to function reasonably well in practice. This is undoubtedly due in no small measure to the fact that the parties to CAA hearings are generally commercially sophisticated and are able to devote the necessary resources of executive time and financial expenditure to ensuring full participation in the hearing regime. Air traffic licences are commercially valuable and CAA hearings are often strongly, even bitterly, contested by the parties. This may especially be the case where an intending operator

\textsuperscript{72} For a discussion of some of the controversial issues which can arise in relation to bilateral agreements see Prosser, "Legal and Administrative Problems of Airline Deregulation in the United Kingdom" in Bridge et al (eds), \textit{United Kingdom Law in the Mid 1990s} (United Kingdom National Committee on Comparative Law, 1994), p 331.

\textsuperscript{73} See Civil Aviation Act 1982, s 67(5); 1991 Regulations, \textit{supra} note 68, clauses 27-29.

\textsuperscript{74} See \textit{Laker Airways Limited v Department of Trade} [1977] 2 All ER 182.
wishes to provide a new service in competition with existing services provided by other carriers.\textsuperscript{75}

The decline in significance of the CAA hearing procedures mirrors the corresponding reduction in the use of formal adjudicative procedures in US regulation, although the reasons for this in both jurisdictions may be somewhat different. Recent US experience with public hearings in the rate-setting area has been that pre-hearing settlements and other forms of consensual process are being employed to an increasing extent by the state public utility commissions. In the next chapter this development will be canvassed in greater detail when some applicable US case studies are considered.\textsuperscript{76}

Similarly, in relation to federal licensing procedures, the US courts have tended to limit the application of the formal hearing procedures in the US APA in this area,\textsuperscript{77} although this development has been the subject of criticism on legal and constitutional grounds by some US commentators.\textsuperscript{78} Such a trend has arisen in part from the willingness of the US courts to recognise the use of informal adjudicative proceedings outside the US APA requirements in the interests of promoting administrative efficiency.

The US APA procedures relating to formal hearings provide for specialist administrative law judges, although there is probably little difference in practice here from the CAA regime given the expertise of the panel members presiding over CAA licensing hearings and the fact that they are also able to receive expert advice from appropriate officials. Intervenors generally have more liberal rights to participate in US

\textsuperscript{75} An example of such intense competition was the recent opposition by British Airways to an application by British Mediterranean to increase its services on the London-Beirut route. See article in \textit{The Times}, 19 October 1995: "CAA in dock as regulator".

\textsuperscript{76} See parts 10.2 to 10.3 of chapter 10.

\textsuperscript{77} See for example \textit{United States v Florida East Coast Ry Co} 410 US 224 (1973); \textit{United States v Allegheny-Ludlum Steel Corp} 406 US 742 (1972); \textit{Buttres v United States} 690 F.2d 1170 (5th Cir. 1982).

\textsuperscript{78} See for example Howarth, "Federal Licensing and the APA: When Must Formal Adjudicative Procedures Be Used?" (1985) 37 Admin LR 317. Howarth summarises his argument at p 321 in the following terms: "This article will demonstrate that the APA's adjudicative procedures...should be invoked and utilized in federal licensing decision-making on a much more frequent basis than case law and precedent would seem to indicate. Indeed, it is submitted that whenever a statute or the Constitution requires that a federal licensee be granted some sort of hearing, the APA's adjudicatory procedures should be presumed to apply absent an explicit congressional indication to the contrary."
regulatory hearings than under the standing requirements applicable to objectors in terms of the CAA regulations. Again this may not be particularly significant in practical terms in relation to CAA hearings, which usually involve sophisticated commercial participants.

Overall, it is of interest to note that, in both the United States and the United Kingdom, the popularity of formal adjudicative hearings in regulatory matters appears to be declining, albeit for somewhat different reasons in each jurisdiction. In the United States pre-hearing settlements and the use of consensual procedures have become more widespread in recent years, as the US case studies to be discussed in the next chapter will illustrate. Such developments have not been as widespread in UK practice to date, though this situation may well change as the regulatory regimes for the various industries mature. In the meantime, the CAA public hearing procedure represents what is probably the last surviving example of a formal adjudicative process in UK economic regulation, and one which is progressively diminishing in importance following the recent developments in the industry which have been described in part 7.6.2 (ii) of chapter 7.

9.6 Rules and Discretion in Relation to OFTEL Licence Conditions

9.6.1 Background to the first OFTEL Public Hearing

OFTEL's commitment to a policy of transparency has been described earlier in part 9.2.2 of this chapter. OFTEL has also sought to implement this policy (which is strongly supported by the present Director General of Telecommunications, Mr Cruickshank) by announcing an intention to hold periodic public hearings on matters of interest in telecommunications regulation. The first such hearing was held in London on 23 November 1995. This hearing principally concerned the Director General's

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79. OFTEL public hearing in the Great Hall, Kings College London, Strand, London, Thursday 23 November 1995, from 9.30am - 1.00pm. I wish to acknowledge the contribution of Mr Paul Ryan, of the Licensing Policy Branch of OFTEL, who provided much useful material and information on the proposed licence condition to me during an interview with him at OFTEL on 12 February 1996. Mr Ryan, who was a solicitor on secondment to OFTEL from a City law firm until April 1996 and who is now working with a telecommunications consultancy in Brussels, also kindly read the first draft of this part of the chapter and provided a number of useful comments and corrections in relation to it. I am also grateful to Mr Colin Scott, Lecturer in the
proposed licence condition relating to anti-competitive practices, a topic which will now be discussed in more detail in relation to the design of regulatory rules.80

In commenting on the programme for the public hearing Mr Cruickshank observed that the occasion was of some significance.81 In the event, the proceedings of 23 November 1995 were not so much a hearing in the traditional sense, as a symposium at which various representatives from parties with an interest in the telecommunications regulatory process were able to put forward their views. This process was followed by about one and a half hours of public discussion from the floor in which a variety of opinions, both thoughtfully argued and otherwise, were expressed.

The background to the proposed amendment to the BT licence was as follows. Following complaints to OFTEL about the effectiveness of the regulatory regime, the concept of introducing a general licence provision dealing with anti-competitive behaviour and fair trading concerns was raised in OFTEL's Consultative Document of December 1994, which set out a framework for effective competition.82 In this document OFTEL discussed the possible need for a general condition of this kind given the reality that legislative amendments to reform Britain's competition laws were

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80. See OFTEL press release 62/95 dated 9 November 1995: "OFTEL Announces Programme for Public Hearing." (I am grateful to Professor Norman Lewis of the Faculty of Law, University of Sheffield, for kindly drawing this hearing to my attention when I met with him in Sheffield on 10 November 1995, Professor Lewis having noticed this press release appearing on the Internet. I subsequently attended that public hearing on 23 November 1995.) A number of OFTEL documents and materials can be accessed through the OFTEL internet web site at http://www.oftel.gov.uk.

81. Quoted in the OFTEL press release, ibid: "This hearing is the first of its kind. I hope that a broad spectrum of interested parties will attend and contribute. I will welcome feedback both at the event and afterwards on how OFTEL should conduct future public hearings to ensure that the UK regulatory regime is open and transparent."

82. See OFTEL Consultative Document, A Framework for Effective Competition (OFTEL, December 1994), chapter 9. In paragraph 9.6 of this document OFTEL observed that: "A general condition on anti-competitive behaviour might achieve flexibility and comprehensiveness at the expense of clarity - both for the established operators and for competitors."
probably unlikely in the medium term. It noted that the terms of clause 17 of the existing BT licence prohibited undue preference and undue discrimination in the supply of telecommunications services, but that some operators had argued that the scope of this provision was too narrow.

OFTEL noted that there were certain areas, such as network-specific customer interfaces that restricted customer mobility between operators, which did not appear to be covered sufficiently by the existing regulatory regime. It also saw the lack of availability of effective enforcement procedures in relation to anti-competitive behaviour to be an area of some difficulty. OFTEL sought views on the possible introduction of a suitable general licence condition dealing with anti-competitive behaviour.

Following receipt of submissions on the Consultative Document OFTEL formulated a policy position in its July 1995 statement. It noted a generally held view that there were gaps in the coverage of existing licence conditions, particularly in the case of BT, and favoured the adoption of a general licence condition in this area. The considerable discretion to be given to the Director General would be exercised in accordance with published guidelines and it was envisaged that a formal two stage representation process would be incorporated into the process of complaint investigation.

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83. The Queen's Speech on the opening of the 1995-96 Parliament did however contain reference to the fact that a review of existing UK competition law was to be undertaken. However, it remains to be seen whether any significant legislative changes will result from this.

84. *OFTEL Consultative Document, supra* note 82, paragraph 9.12: "Some operators have argued that OFTEL has not been able to act effectively against various types of predatory behaviour. They argue, in particular, that Condition 17 is not sufficiently broad to enable OFTEL to take action in circumstances where BT is introducing new services in an anti-competitive way. Other commentators argue that Condition 17 does bear a wide interpretation, and that a determination may be made by the Director General under this condition in a very broad range of circumstances."

85. *Ibid* paragraph 9.13. In *Doing Business with OFTEL, supra* note 12, OFTEL listed at paragraphs 4.18-4.23 some areas where complaints commonly arose, such as undue delay on the part of the dominant operator in negotiating interconnection agreements.


hoped that the proposed condition would serve to reduce the complexity of telecommunications licences.\textsuperscript{88}

A draft of the proposed licence condition on anti-competitive behaviour was included as Annex C to the July 1995 statement. This draft condition, with some subsequent modifications, was considered further at the OFTEL public hearing in November 1995. Copies of the BT version of the licence condition, issued on 9 November 1995, and the subsequent OFTEL version dated 14 November 1995, as considered at the public hearing, are included as Appendix I to this chapter.

Following the public hearing, the OFTEL version of the condition was further amended. A subsequent version was incorporated in Annex A to the OFTEL Statement of December 1995,\textsuperscript{89} and this will be considered in more detail below. The drafting changes in this version were largely cosmetic rather than substantive in nature. The final version of the condition is described in more detail in part 9.6.11 of this chapter.

9.6.2 OFTEL's Position at the Public Hearing

It is of interest to consider some of the views which were expressed at the public hearing on 23 November 1995, as these have not been canvassed elsewhere at the time of writing.\textsuperscript{90} The Director General of Telecommunications, Mr Cruickshank, began the hearing by a short address in which he set out the matters at issue. He pointed to the fact that OFTEL's role in the telecommunications market had evolved over the past two or three years from that of facilitator of the process of industry competition to

\textsuperscript{88} Ibid paragraph 6.36: "OFTEL believes that a general licence condition concerning anti-competitive behaviour will, over time, reduce the need for detailed, behaviour-specific, fair trading licence conditions. While the majority of respondents did not consider that the stage had yet been reached when BT could be relieved of any of its detailed licence conditions, OFTEL does intend to reduce the complexity of BT's licence....As competition develops further and the proposed licence condition on anti-competitive practices is seen to have the effect of changing the role of licences in regulating licensees' conduct, OFTEL expects that a number of other detailed conditions may become unnecessary and should be deleted."

\textsuperscript{89} See \textit{Statement Issued by the Director General of Telecommunications, Fair Trading in Telecommunications} (OFTEL, London, December 1995).

\textsuperscript{90} In writing this part I have made reference to the indexed, 125 page OFTEL transcript of the hearing held on 23 November 1995. I am grateful to Mr Paul Ryan of OFTEL for making a copy of this document available to me.
In order to carry out this task adequately, OFTEL needed, in his view, to have the right tools for the job. He considered that the existing licence conditions for telecommunications operators were designed for the situation of a privatised monopoly (many having been drafted in 1984 at the time of the original privatisation of BT) and not for a competitive regime. Such a regime required flexible and enforceable rules which could be effectively monitored and enforced by OFTEL.

The Director General went on to state that he did not believe that BT had sufficient internal compliance programmes in place and that it exhibited a natural tendency not to initiate such programmes in the absence of regulatory intervention or direction. The proposed new licence condition was designed to shift responsibility for compliance onto BT. It was put forward because OFTEL was concerned about barriers and delays to market entry, which were costly to prospective market entrants. There was also concern about the effect of such practices on consumers. The object of introducing a general prohibition against anti-competitive behaviour was not to reduce BT’s market share, but to allow BT and other operators the opportunity to innovate. The suggested licence condition was put forward in the context of a telecommunications market which was still heavily dominated by one vertically integrated company with ubiquitous coverage. The licence condition was in fact deregulatory in nature in that it would mark a trend away from a plethora of intrusive controls on BT’s business.

On the issue of discretion, the Director General noted that he already had wide discretionary powers under the present licence conditions, so that it was inaccurate for

91. *Ibid* p 4: "Our role - my role - is changing from facilitator to enforcer, if that is not too ‘wild west’ an analogy. Ensuring fair competition for customers with a choice is becoming as important as promoting competition for customers who have, as yet, no choice. So a change of focus is one of the issues we are dealing with today."

92. *Ibid* pp 6-7:

"Operators have also made it clear that I have to act swiftly to stop anti-competitive practices. They state, rightly, that delays are extremely costly to operators, particularly new entrants. My concerns are the delays already caused to the customers.

The licence modification process is very slow if that is the route we have to go. The licence is intended to set out rules, and my efforts should, I believe, be directed to ensure that operators comply with these rules.

I do not believe it is appropriate, nor do I believe it was the intention of Parliament, that I should be spending my time continually modifying the detailed rules."
BT and others to assert that the proposed condition represented a totally new departure from the existing regime. The regulator's discretion would be exercised in the context of published guidelines. In Mr Cruickshank's view, the adoption of the proposed conditions, together with the application of best competition law practices, would provide a measure of certainty in the telecommunications industry. He emphasised that the proposal should not be regarded in the context of BT versus OFTEL, but was rather an initiative that was required for the overall development of the telecommunications market. The condition would particularly bite on dominant parties in the industry, such as BT, and the Director General intended to apply the full rigour of the powers which would be granted to him under the licence amendment to addressing anti-competitive practices in the telecommunications industry.

9.6.3 The View of the Cable Companies

The Director General was followed by Mr Wayne Gowen, the Managing Director of Telecommunications Comcast Europe Ltd, who represented the cable companies. He welcomed the hearing as being a positive example of transparency in UK telecommunications regulation, but noted that, despite the existence of some 150 licensed telecommunications operators in the UK, BT still enjoyed 85% of overall call volume along with 90% of all direct connections and remained the clear market leader by reason of its size, scale and scope.93

In his view OFTEL required effective powers to control anti-competitive behaviour so as to achieve a regulatory regime that was effective, transparent and provided participants with proper avenues of redress. While it might require primary legislation to achieve these goals fully, the proposed licence condition represented a good beginning. He pointed to the fact that existing licence conditions were inflexible and gave incomplete coverage of industry issues. Complaints often took a long time to investigate (three years in one case of which he was aware) and were dependent for

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93. Ibid p 15: "Despite new entrants to the market, BT is still a formidable barrier to entry. Its dominant advantages include, for example, the ubiquity of its network, the continued lack of number portability, and its tight control of the number information database. These structural strengths put BT in a very strong position."
their successful conclusion on a finding by OFTEL that a particular licence condition had been breached.

Mr Gowen considered that the present regulatory regime was narrow and inflexible and gave rise to unacceptable delays, all of which favoured the incumbent monopoly supplier.\textsuperscript{94} In his opinion OFTEL was under-resourced, and took too long to investigate complaints. Furthermore, there was no effective commercial redress available to a third party, such as an action for damages in respect of anti-competitive conduct, and there was therefore no effective deterrent which would impact on an industry such as BT. While many of these problems were not the fault of OFTEL or its staff, but had really arisen from the novel situation of dealing with a privatised industry and a new regulatory regime, there was a need for the process of regulation to be sufficiently well-resourced and to adopt a clear and unambiguous approach. He took the view that transparency of procedure, coupled with the use of sensible and clear licence provisions, provided the only realistic avenue in the short term under which an aggrieved party could seek redress under the regulatory process.

9.6.4 BT's views

Mr Gowen was followed by Mr John Butler, Director of Regulatory Affairs at BT. He addressed three issues. First, was the proposed power necessary? Secondly, if it was necessary, was the Director General's proposal the best one? Thirdly, BT had developed an alternative proposal which it wished to advance.

Mr Butler began by stating that BT doubted whether a general discretionary power of the type suggested was in fact needed. In its view the regulator was essentially a non-ministerial government department with limited accountability to Parliament. The powers of the regulator were huge and regulatory actions exerted a substantial influence on BT's pricing and industry structure. He pointed to the fact that BT was willing to comply with all reasonable regulatory requirements but believed that sweeping powers of the kind proposed were unnecessary.

\textsuperscript{94.} \textit{Ibid} p 17: "Remember delay is the dear ally of the incumbent and the dire enemy of any new entrant."
BT had two major criticisms of the existing regulatory structure for telecommunications. These were, first, that an individual regulator should be replaced by a regulatory commission or alternatively a panel structure involving an advisory committee or similar mechanism. Secondly, the provision of an adequate appeal structure needed to be addressed. The existing processes of judicial review and review by the MMC were too restrictive and needed to be replaced by a more general right of appeal. The Director General should be bound by guidelines placing some limits on what was otherwise an unacceptable breadth of discretion, although he noted that the Director General had now agreed to be bound by legal precedent and relevant decisions of the European Commission in the competition law area. In BT's view, the consequence of vesting broad and poorly defined discretionary powers in the regulator would be to "stifle innovation, reduce BT's efficiency, and add to consumer's costs."

BT considered that an improved regulatory regime would involve a number of aspects. First there needed to be a separation of investigatory and adjudicatory functions. Secondly the Director General needed to display a greater understanding of the implications of accounting separation. In relation to regulatory decision making, a licensee needed to have time to prepare a defence to any complaints made against it and was entitled to have the Director General give fair consideration to its position. Reasons for decisions needed to be given and any remedies proposed by the regulator needed to be proportional to the regulatory offence being addressed. The regulator should be bound by legal precedent and by previous regulatory decisions and there needed to be a mechanism for independent scrutiny of the merits of a Director General's decision.

In practical terms, the implementation of these proposals would involve a number of procedural and structural innovations. BT considered that OFTEL should have a separate hearing officer. Guidelines needed to be defined in the interests of due process

95. *Ibid* p 31: "The second key area for progress and improvement is in the area of appeals. In general, there is no process for resolving disputes between the regulator and a regulated company. Judicial review of the DG's action is not available on the merits of the case. Only in the case of a proposed licence amendment is there another option. If we fail to consent to a proposed licence amendment, and we decline to accept it, the Director General may refer the matter to the Monopolies and Mergers Commission. BT has no right to ask for a dispute to be taken there. When the MMC reports, the Director General does not have to do what it recommends."
and natural justice. It considered that the exceptionally wide powers sought by the Director General were unnecessary and disproportionate to the needs of the industry.

BT proposed an alternative mechanism. Under its proposal, the Director General would investigate any alleged anti-competitive activity. OFTEL would have a major new power - that of issuing an interim direction to a licensee to cease and desist from the activity which was the subject of complaint. This power would apply to all UK telecommunications operators, not just BT. The exercise of the proposed injunctive power would involve three tests. There were: whether the complainant would suffer irremediable loss; whether the needs of consumers justified the exercise of the power and whether it was in the broader public interest to grant such relief.

9.6.5 Other Points of View

Mr Butler was followed by Professor John Kay, of the London Business School. Professor Kay identified the principal issues for consideration as being the desirability of the use of general discretionary powers as opposed to specific licence conditions, whether additional appellate mechanisms were needed and whether some form of injunctive remedy was desirable.

He began by noting that the choice of rule structure involved the exercise of judgment and an appreciation of the economic structure of the industry. In his view there was little hope that a series of definitive rules governing every conceivable situation could be developed, which raised the need for a degree of regulatory discretion involving principles formulated in a general fashion. He noted the possible use of alternative means of determining disputes, such as arbitration between the parties and investigation by an independent expert with the ability to obtain appropriate advice and relevant evidence bearing on the dispute. Adversarial processes were unproductive in the regulatory area and general principles were also preferable to specific prohibitions.

96. Ibid p 36.
97. Ibid p 46: "...there is actually no hope, however desirable it might be in this area, of prescribing regulation by reference to a series of definitive rules. Because of this inevitable necessity for the exercise of judgment, the best one can do, and the best one should do, is to define a series of general principles and allow these to evolve over time."
Overall, he favoured the use of an independent third party as being the desirable structure. Under his preferred regime, abuse of market position would need to be described more specifically and would conceivably involve reference to concepts such as the level of direct detriment to consumer interests and the ways in which the behaviour complained of served to inhibit efficient competition.

On the subject of appellate procedures, Professor Kay expressed the view that rights of appeal or review should be limited to a restricted category of issues which were central to the concerns of the parties and should not be available in relation to questions on which differing points of view might reasonably be held by well informed parties. He considered that, in general, the approach advocated by the Director General of a general discretionary power with some specific guidelines was correct in principle. Such a power might need to be accompanied by an expanded definition of the concept of abuse of market power.

Professor Kay was followed by Dr Keith Monserrat, Director of Operations for Scottish Telecom plc, who outlined the experience of Scottish Telecom with access and interconnection issues involving BT. He asserted that BT had adopted a number of strategies designed to delay the entry of Scottish Telecom into the UK market. These included tactics such as delaying confirmation of orders through the use of continual requests for further information, delaying the providing of information concerning contracts and prices, last minute changes to pricing, setting unrealistic time scales for finalising contracts and prices and failing to meet project milestones and agreed commencement dates.98

In his view the cumulative impact of these actions had been to delay the commencement of operations by Scottish Telecom, to bring about a loss of revenue and to give rise to customer dissatisfaction. On the latter point he believed that last minute pricing changes had the effect (possibly intentionally) of undermining the planning

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98. *Ibid* pp 63-64: "May I, therefore, then take a specific example? Based on experience, in trying to launch a new service, we have encountered the following: there has been a delay in the confirmation of orders by continual requests for information, and remember the order does not begin until it is actually signed, the time taken to process the order. There is a delay in the provision of contracts and prices. There are last minute changes to pricing. There are unrealistic time scales for finalising contracts and prices. Once you have gone through all of that, once you have established a pricing mechanism, there is a failure to meet project milestones and agreed go-live dates. This has major impact on a new operator."
procedures of new operators and discrediting them in the eyes of the market. In terms of remedies, these were limited under the existing regime. A complaint to OFTEL was only feasible where a licence condition had been breached and this was not always a straightforward issue to determine. Furthermore the current regulatory system did not address flow-on effects arising from the use of delaying tactics and subtle barriers to market entry by the incumbent monopolist. The regulatory regime as a whole involved lengthy and resource-intensive processes and allowed no compensation to other operators in areas such as loss of market credibility or loss of revenue and profits. By reason of the absence of effective sanctions, the present regulatory structure effectively served to encourage anti-competitive behaviour.

By way of conclusion, Dr Monserrat advocated the adoption of the proposed condition on the basis that it represented a positive step forward. The conferring of a general discretion on the Director General enabled him to address market abuses and to "plug the gap" caused by inadequacies in the general competition law. He criticised BT's alternative proposal on the grounds that it offered no positive remedies to other market operators but simply rehashed the existing law and procedures. In his view, an increase in the speed of the regulatory process should not occur at the expense of a corresponding loss of regulatory effectiveness. He supported the existence of a right of appeal to the MMC and the adoption of some mechanism to provide compensation to third parties for anti-competitive behaviour.

9.6.6 Views from the Floor

After a short break the period of public discussion from the floor began. The Chairman of the meeting, Mr Richard Thomas, Director of Public Policy at Clifford Chance, the City law firm, introduced this part of the hearing. He called for constructive discussion directed to the four principal issues of the need for a general discretionary licence condition of the kind which had been proposed, considerations arising from the need for certainty as opposed to the need for regulatory discretion, procedural and appeal issues and finally the merits of the alternative approaches which some of the speakers had suggested.
The ensuing discussion was marked by participation involving a wide range of persons and viewpoints. Businessmen and regulatory lawyers were well represented, along with at least one former member of the MMC, several investment analysts and one or two disgruntled members of the public. The discussion concluded at about 1.00pm with a question from a single journalist, the Chairman having set aside time for the media to participate in the hearing. A range of views was expressed both for and against the proposed licence condition. Members of the panel answered specific questions and provided their own commentaries and contributions to various areas of the debate.

As was no doubt predictable, a divergence of view between BT and representatives of the other telecommunication companies was evident, as well as between BT and OFTEL. A Mr John Williams, representing another telecommunications company, Audioline, noted that his company had lodged a complaint with OFTEL in March 1994 concerning anti-competitive behaviour by BT. This had involved his company in considerable expense in retaining lawyers and other experts, including industry researchers, and much effort had also been devoted to determining whether a particular condition of the BT licence had in fact been breached. OFTEL had finally given a ruling in September 1995, following some delay on the part of BT in responding to the complaint. Mr Williams noted that delay favoured the incumbent monopolist, given that the market entrant was losing revenue in the meantime and indeed might not be able to enter the market at all if the dispute involved matters such as the terms of interconnection to the BT network. He considered that the Director General should be given adequate powers to address deliberate delay and prevarication where this had an anti-competitive effect.

Mr Colin Baylew, a former member of the MMC, expressed the view that he would be reluctant to see the MMC review procedure abandoned, which might be a foreseeable result of the adoption of wide discretionary powers under the OFTEL proposal. These would probably be difficult to challenge on review and might remove some of the protection available to licensees under the current procedure. Professor Kay responded

99. *Ibid* p 83: "The problem is that time is money. So far as our business is concerned, we have lost eighteen months of market activity. BT have lost not a jot. They have benefited from continuing this action."
to this speaker by expressing the view that it was desirable for the MMC's role to be restricted to issues of broad industry policy and relevance, rather than to second-guessing individual decisions made by OFTEL.

9.6.7 Evaluation of the Views Expressed

An analysis of the views expressed by the speakers and by the public participants at this hearing is instructive in that it reveals the approach adopted by differing parties to the regulatory process. The industry regulator, OFTEL, recognising the difficulty of relating alleged breaches to specific licence conditions, favoured the flexibility afforded by a licence provision embodying wide discretionary powers. Such a provision would be particularly useful in addressing anti-competitive behaviour such as delay, prevarication and conduct aimed at discrediting competitors in the perception of their customers or in the market.

The experience of Scottish Telecom, as related by Dr Monserrat, indicated that such conduct might be far from being a purely hypothetical occurrence. Furthermore the breadth and variety that such anti-competitive conduct could take meant that it was difficult to design a licence condition which was adequate to counter such behaviour without conferring broad discretionary powers on the regulator.

The views expressed by other telecommunications operators were also of interest. While some of these invoked the consumer interest, it would be unduly naïve to assume that these parties were motivated solely by issues of altruism. However, this may be one area in which the pursuit of commercial advantage and the consumer interest might tend to coincide, if the end result was a telecommunications market in which a large number of participants could offer a genuinely competitive service of comparable breadth and coverage.

The other operators placed some importance on a regulatory regime which had adequate capability to address anti-competitive behaviour and where the regulator also had sufficient powers to provide an effective deterrent to a dominant party such as BT. The need for an expeditious system involving transparency and third party rights of action against the incumbent monopolist were also features that were regarded as
desirable by these parties. The continuing need for regulatory control over anti-competitive conduct, particularly in relation to issues such as interconnection, was recognised. While it might be regarded as somewhat paradoxical if increased competition in the telecommunications market led to a stronger regulatory regime, it is not inconceivable that such a result might arise out of the concerns expressed by the independent operators.

The views expressed by academic commentators such as Professor Kay are also of interest. These recognised the foreseeable advantages which might flow from giving the Director General adequate discretionary powers to address anti-competitive behaviour. The suggestions made that combining such a power with specific guidelines together with more specific definition of the concept of market abuse by a dominant party seem to this writer to be eminently sensible.

The merits of abandoning adversarial processes altogether in favour of investigations by an independent expert, as advocated by Professor Kay, might be more debatable. One does not need to have participated in litigation and arbitration processes for a particularly long period to appreciate some of the marked advantages which flow from procedures such as discovery, inspection of documents, the power to compel the attendance of witnesses at a hearing and the ability to submit evidence to testing by cross examination. These are features which have long been designed to test the accuracy and completeness of evidence adduced at a hearing.

The need to adduce sworn evidence, backed by stringent penalties for perjury, is seen by parties involved in the US regulatory process to be crucial to the successful functioning of a regulatory regime. The discussion in the following chapter on this point will mention the results of some empirical work undertaken in this area with regulatory bodies in the United States.\textsuperscript{100} The above matters are all advantages which even the most determined and best qualified of independent experts might find some difficulty in matching. Having said all this, there is no denying that opportunities exist for streamlining adversarial procedures. In cases which depend heavily on the conflicting evidence of opposing economists there may be scope for requiring such expert witnesses to reach a consensus of opinion for the benefit of the court or tribunal.

\textsuperscript{100.} See part 10.3 of chapter 10.
Such an approach has been advocated in other jurisdictions such as Australia and New Zealand, and will be canvassed further in chapter 11.\textsuperscript{101}

Similarly, in relation to the abandonment of MMC appeal or review processes, such an approach might be justified when UK regulatory experience is further advanced, it is doubtful whether this point has yet been reached. Such a time might also be characterised by the evolution of wider powers of judicial review, perhaps along US lines. Some suggestions as to how such procedures might evolve have been made in the previous chapter.\textsuperscript{102}

9.6.8 Specific Aspects of the OFTEL Proposal

As mentioned above,\textsuperscript{103} following the public hearing of 23 November 1995 the OFTEL version of the proposed licence condition was incorporated in an Annex to the December 1995 OFTEL Statement. A summary of the principal features of this document follows.

The December 1995 Statement furthered the consultative process on the subject of effective competition and the content of the proposed new licence condition relating to anti-competitive market practices. The Statement set out OFTEL's views on the need for the new licence condition, provided details of the proposed condition and of suggested deletions from BT's licence and also set out for the first time the applicable guidelines relating to OFTEL's application of the proposed licence condition.

In the Statement, OFTEL noted the fundamental changes occurring in the telecommunications market, where competition in different areas of the market is unevenly distributed, with BT remaining dominant in many areas whereas other areas are now quite competitive, and described the need for a responsive regulatory

\textsuperscript{101.} See part 11.4.1 of chapter 11.

\textsuperscript{102.} See part 8.3.6 of chapter 8.

\textsuperscript{103.} See the text accompanying note 89, supra.
OFTEL put forward the view that an appropriate regulatory approach for the new telecommunications market should involve lighter and firmer regulation. It considered that the following features were necessary: effective and speedy interim relief accompanied by appropriate third party rights, a comprehensive level of coverage, a regulatory system which imposed minimal burdens and was transparent and finally a system which was of general application "to all significant licensees".

In OFTEL's view, the content of the present licences was not satisfactory, particularly in the case of those granted to BT and Mercury. These licences contained detailed conditions, some of which related back to the time of BT's initial privatisation and to the duopoly period in the telecommunications market. They contained gaps and often did not cater for technological innovations and new developments in more recent times. Attempts to remedy this situation in the past had led to continual licence modifications, a process which was slow and unwieldy. In general terms, OFTEL wished to lessen its involvement in detailed rule setting and move to what it considered to be a more flexible and effective process of licence enforcement, in conformity with the increasingly competitive telecommunications market.

In Section Two of the December 1995 Statement, OFTEL explained the provisions of the proposed new licence condition. It noted that the condition sought to incorporate accepted principles of EC competition law which had been adopted as part of the domestic laws of most of the Member States (although not fully adopted to date in the United Kingdom.) OFTEL listed some typical practices which it envisaged would be caught by the condition, including refusal to supply customers competing in a

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104. *OFTEL Statement, supra* note 89, paragraph 1.3: "Regulation must evolve to meet the challenges of this rapidly changing market, vibrant with the activities of emerging competition. Regulation is an imperfect substitute for competitive market forces, which can be hindered rather than encouraged by the maintenance of heavy-handed, backward-looking rules. To meet these challenges OFTEL needs to be able to take effective and speedy action against anti-competitive practices, while beginning the essential process of withdrawing from prescriptive rule-making and detailed price control."


107. *Ibid* paragraphs 1.15-1.19. As OFTEL noted in paragraph 1.19: "OFTEL's role in the market is undergoing a shift in emphasis from that of a regulator engaged primarily in designing licence conditions and dismantling entry barriers, to that of a competition authority ensuring that emerging competition is sustainable and not put at risk by anti-competitive practices."
downstream market on reasonable terms, denigration of competitors, extended negotiations over access and interconnection and exclusive supply arrangements of excessive duration.\textsuperscript{108}

If the proposed condition was introduced OFTEL intended to delete a number of obsolete conditions from the BT licence as a consequence and following appropriate consultation.\textsuperscript{109} It also proposed to introduce the new licence condition into all significant telecommunications licences over the period of time set out in Annex C to the Statement. This provided for a timetable commencing with an amendment to BT's licence in June 1996 and extending progressively to other licensees, with the process being completed by the end of December 1997.

The need for consistency and due process was addressed in Section Three of the Statement. OFTEL proposed the adoption of various guidelines in relation to the exercise of its discretion under the proposed condition.\textsuperscript{110} These guidelines would not be binding in law on the Director General, who had a broad discretion under the Telecommunications Act. However they were designed to illustrate OFTEL's likely approach to certain issues, such as market dominance and the effects of particular market behaviour under specified circumstances. The draft guidelines were contained in Annex D to the Statement and were to be the subject of consultation. It was intended that the guidelines would develop over time and would reflect changes in the market. OFTEL intended to keep them continually reviewed and subject to periodic consultation.

Section Three of the Statement also dealt with the role of expert advisors (a regime which was to continue but without being formalised), transparency of enforcement

\textsuperscript{108} Ibid paragraph 2.2.

\textsuperscript{109} Ibid paragraphs 2.5-2.10.

\textsuperscript{110} Ibid paragraphs 3.4-3.8. The use of guidelines in this way has received judicial approval from the House of Lords in \textit{British Oxygen Co Ltd v Minister of Technology} [1971] AC 610. For similar cases see \textit{McLean v Paterson} 1939 SC 52; \textit{In re Findlay} [1984] 3 WLR 1159. In \textit{R v Secretary of State for the Home Department, ex parte Khan} [1985] 1 All ER 40 immigration guidelines issued by the Home Secretary were held by the Court of Appeal to be binding on the department when considering an immigration application, the applicant having a legitimate expectation that the policy previously laid down would be followed.
techniques and finally included some comments on BT’s alternative proposal. OFTEL’s views on this latter aspect will be dealt with further below.

The proposed licence condition was aimed at avoiding some of the enforcement difficulties which arose under the Telecommunications Act, where the Director General could only make a provisional order in the case of a past contravention where the contravening circumstances were likely to recur in the future.\textsuperscript{111} This gave rise to obvious problems for OFTEL. The Director General had to be able to show that the problem was likely to recur in the future, a test which generally required some degree of inference based on an analysis of the systems employed by the operator in question in the particular area under scrutiny. An operator which was the subject of enforcement proceedings might claim that the difficulty arose from an isolated or one-off problem, perhaps caused by an over zealous manager or lax oversight in the particular circumstances. OFTEL has so far only sought to exercise its powers under s 16(2) on two occasions, the more significant of which involved an examination of BT’s systems in relation to the pricing of services for particular satellite ground stations. An order was made in late 1995 based on perceived deficiencies in BT’s internal systems in this area.\textsuperscript{112}

9.6.9 Analysis of BT’s Alternative Proposal

Some reflection shows that the response by BT to the Director General’s proposals was also somewhat predictable. While BT’s views evinced an admirable degree of support for the doctrine of Parliamentary sovereignty and the need for greater regulatory accountability, one does not need to be unduly cynical to recognise more than a passing degree of self-interest here. Closer examination of BT’s alternative proposal reveals a mechanism which seems justifiable on its face, but which on analysis is seen to favour the interests of the industry incumbent to a significant extent.

\textsuperscript{111} See Telecommunications Act 1984, s 16(2)(a).

\textsuperscript{112} See NTL Satellite Uplifting Order (OFTEL, December 1995). I am grateful to Mr Paul Ryan for his helpful assistance in supplying information on these aspects of the OFTEL enforcement regime during my interview with him, \textit{supra} note 79.
The replacement of a discretionary power to prohibit an anti-competitive activity with a power to investigate such an activity reveals an alternative mechanism which is likely to prove much less troubling to an incumbent monopolist. Presumably any investigative power would still need to be related to breach of a specific licence condition. The discussion earlier in this part of the chapter showed that such an approach lacked flexibility and breadth of coverage, and these drawbacks would undoubtedly favour the commercial interests of a market leader such as BT. Similarly, the adoption of a procedure involving an interim direction to desist from a particular activity, as advocated by BT, also has certain discernible advantages for the dominant firm.

In the December 1995 Statement, which sets out OFTEL's view of BT's alternative proposal, the inflexibility of the current regulatory regime was noted. OFTEL considered that BT's alternative proposal was not comprehensive as, under BT's version, a prerequisite for taking action was the commencement of the lengthy and cumbersome licence modification procedure. OFTEL also took the view that BT's proposal lacked flexibility, given that the end result of the procedure is the drawing up of a specific licence condition. Such a remedy failed to address the existing problems encountered in relating enforcement activity to specific conditions of the BT licence.113

OFTEL pointed out that under the BT proposal, licences "would continue in size and complexity", whereas the reverse would be the case under the OFTEL approach, which should lead to a number of redundant licence provisions being deleted.114 The OFTEL proposal would also be of general application, whereas BT's version was specific to a particular licensee as enforcement activity could only lead, under the BT proposal, to the insertion of a specific licence condition restricted in its operation to that licensee.115

Where the imposition of such a remedy, as under the BT alternative, is based on tests which are analogous to those applicable to the granting of an interim injunction it may be difficult for a regulatory body to make out the grounds for such relief. The need to

113. See December 1995 Statement, supra note 89, paragraph 3.19.
114. Ibid paragraph 3.20.
115. Ibid paragraph 3.21.
demonstrate, for example, that a complainant will suffer *irremediable* loss may well prove to be a difficult hurdle for a regulator to surmount. Difficulties of this kind are not infrequently encountered in the interim injunction context. A requirement to show that interim relief is in the interest of consumers or is in the broader public interest may also impose a heavy burden on a regulatory body.\(^{116}\)

The effect of such a test might well be to make a regulator reluctant to invoke these powers except in the clearest of cases. A test of such complexity may also allow an incumbent monopolist considerable scope to challenge regulatory decisions in this area through the use of judicial review procedures. The fact that the OFTEL version of the proposed licence condition gave the Director General sole discretion to determine whether or not an act or omission is prohibited by the new licence condition\(^{117}\) would narrow the ability which a party such as BT would have to object to a particular determination through the MMC review process or by way of judicial review.\(^{118}\)

OFTEL also raised the objection that the BT version did not entitle third parties to seek damages, so that rights of third party redress were lacking. A cogent enforcement method, and an incentive to abstain from anti-competitive behaviour, were therefore absent.\(^{119}\)

Careful consideration of BT's alternative proposal of 9 November 1995 also shows that it has a narrower scope than the Director General's proposal. Under BT's version, the powers exercisable by the Director General are limited to particular statutory

\(^{116}\) For examples of cases where the parties have experienced difficulties in obtaining an interlocutory injunction in the public law context see *Smith v Inner London Education Authority* [1978] 1 All ER 411; *Block Brothers Realty Ltd v Capital Regional District* [1984] 4 WWR 89. The general principles are discussed in Ahern, "Interlocutory Injunctions in Administrative Law: What is the Test?" (1991) 5 CJALP 1.

\(^{117}\) See clause XA.3 of the proposed new licence condition. (OFTEL draft of 14 November 1995, as included in Appendix I.)

\(^{118}\) In cases where a decision maker has been granted an unfettered discretion, challenging such a decision may prove to be extremely difficult provided that the decision taken accords with the object and purpose of the empowering legislation. For illustrations of this principle see *Mayor of Westminster v London and North Western Railway Co* [1905] AC 426 at 427; *Minister for Aboriginal Affairs v Peko-Wallsend Limited* (1986) 66 ALR 299; *Hamilton City Council v Waikato Electricity Authority* [1994] 1 NZLR 741 at 760-761.

\(^{119}\) See *December 1995 OFTEL Statement, supra* note 89, paragraph 3.18.
The regulator's ability to invoke the clause is further limited to the more restrictive criteria set out in BT’s alternative formulation, which requires the Director General to be satisfied that a person "will suffer serious and irremediable loss as a result of that behaviour if he fails to take prompt remedial action." The Director General must also be satisfied that any loss to third parties "will significantly outweigh any loss to the licensee and any detriment to the users of telecommunication services in the United Kingdom resulting from that remedial action." Finally the Director must consider that his actions will be "in the public interest."

Some potential fishhooks for the regulator under the BT alternative proposal therefore become apparent. Under BT's proposal the Director General would be required to weigh the loss to a third party against any loss to the licensee affected by the relief sought and against the detriment to the users of telecommunication services in the UK. Some reflection will serve to demonstrate that such a test would be likely to be difficult to administer in practice and would conceivably seldom, if ever, be met.

A smaller market entrant seeking to show that its "serious and irremediable loss" would "significantly outweigh" the combined loss to BT and the detriment to other users would foreseeably have grave difficulty establishing grounds for relief when its business was at a fledgling stage and any anticipated loss of profits might be largely, if not entirely, hypothetical. Furthermore the application of the BT test would foreseeably involve a huge volume of expert evidence from economists, accountants, statisticians, analysts of the telecommunications market and other experts that could make the practical application of BT's proposed test almost impossible.

The scope for judicial review of the Director General's decision could also be enormous in any particular case. The BT draft expanded the scope for such challenges by requiring the Director General not only to consider representations made by the licensee, but also to inform the licensee "why he has accepted or rejected them." In

120. See BT Alternative Licence Condition, as set out in Appendix I, clause 1(a)(i).
121. Ibid clause 1(a)(ii).
122. Ibid clause 1(b).
some circumstances such a requirement might possibly go beyond the regulator's obligation to give reasons for his decision.

The BT proposal also favoured the licensee against which relief was sought by imposing a strict time limit of 42 days on the Director General to either make an MMC reference, accept undertakings from the licensee or agree to a modification to the licence conditions. On this point the BT version encountered potential jurisdictional problems. OFTEL noted, by way of objection, that it "has been advised that it does not have the power to include an appeal process which fetters the Director General's discretion." Given the Director General's wide discretion under the Telecommunications Act, OFTEL's view might well have been correct as a matter of law. If so, the adoption of BT's suggested appeal mechanism would necessitate a change to the legislation.

While these concerns to expedite the regulatory process may be commendable on their face, the well informed man on the Clapham omnibus, if inclined to take a less charitable perspective, might reach the view that they impose time limits on the regulator which are so stringent as to frustrate any meaningful regulatory action on his part. Certainly they restrict the regulator's ability to enquire into particular forms of anti-competitive conduct. They may also give industry leaders such as BT further room to manoeuvre and to employ their arguably superior resources in marshalling expert evidence to challenge the regulator's actions.

As always, lurking in the background is the reality that delay favours the incumbent. As a matter of competition law principle, there is also authority supporting the view that unjustifiable delay in itself may constitute a species of unfair competition. Some courts have been prepared to categorise such conduct as attempts to exclude competitors from the market. The element of deterrence is also an important aspect

123. Ibid clause 3(b).

124. See December 1995 Statement, supra note 89, paragraph 3.15.

125. Both US and EU competition law recognise an "essential facility" doctrine under which a dominant party in a market who owns networks or facilities to which prospective competitors need access for their operations cannot refuse to allow such access or refuse to grant it on terms which are less favourable than those applicable to the dominant party's own business. A deliberate delay in negotiating or agreeing the terms of such access would seem to fall readily within this general principle. For a discussion of these issues see Whish and Sufrin, Competition
of the OFTEL proposal.\textsuperscript{126} Given the absence of effective sanctions in existing UK competition law against the abuse of a dominant position, the enforceability of the new condition was one of its more attractive features from the regulator's perspective. Instead of being forced to rely on a cumbersome system of continual licence modifications, as at present, the regulator would have power to take swift and effective regulatory action where necessary. OFTEL believed that this would shift the responsibility for monitoring and avoiding potentially anti-competitive conduct back onto operators, where it should properly belong.

9.6.10 An Impasse Develops Between the Parties

(i) Jockeying for Position

Consultation on the December 1995 Statement concluded on 16 February 1996.\textsuperscript{127} As mentioned above, OFTEL's proposed timetable specified incorporation of the new licence condition into BT's licence by June 1996. Both parties realised that an MMC review posed certain risks. OFTEL faced the possibility of its whole approach being rejected, together with problems of inevitable delay. The risks to BT were also great if


126. The deterrent aspect of the proposal was stressed to me by Mr Paul Ryan of OFTEL during my interview with him, supra note 79.

127. The consultation regime relating to the December 1995 Statement provides another example of OFTEL's two stage consultation policy, with the first stage of the consultation having concluded on 2 February 1996 and the second stage on 16 February 1996. For a discussion of developments up to February 1996 see article by Scott, "New Licence Condition for BT Concerning Anti-Competitive Conduct" (1996) 7 Util LR 7.
the MMC was to side with OFTEL, an outcome which on previous experience was not inconceivable.

This was especially the case given that the political risk for BT from a possible change of government might be significant. An incoming Labour government might well choose to implement an MMC report on this issue in full or to a substantial extent, leading to adverse commercial consequences for BT. On the other hand the process was not without risk from OFTEL's perspective. If the MMC were to conclude, for example, that the Director General's approach was misdirected, or resulted in the grant to him of excessive discretionary power, then the whole thrust of OFTEL's proposed enforcement regime would immediately be placed in jeopardy.\textsuperscript{128}

In the early part of 1996 BT mounted a concerted campaign in favour of its position both in the press\textsuperscript{129} and among its shareholders.\textsuperscript{130} In a circular letter to shareholders issued in February 1996 BT claimed that the regulator's proposals unduly favoured its competitors, were too vague and suffered from the lack of an adequate appeal mechanism. BT also claimed that the OFTEL initiatives would allow the regulator to dictate the terms on which BT carried on business by obliging BT to give parties to interconnection arrangements advance notice of new services and of the proposed date of their introduction.

BT's argument on this latter point was rather a subtle one. While the OFTEL draft of the proposed licence condition did not expressly raise the spectre of such regulatory intervention, BT believed that the Director General could use (or, in BT's view, misuse) the proposed condition so as to impose price caps on BT by holding a particular BT pricing practice to be anti-competitive. OFTEL denied that it had this object in mind.

\textsuperscript{128} My discussions with Mr Paul Ryan of OFTEL, \textit{supra} note 79, indicated that it was likely that both parties perceived the significant risks attaching to the MMC review process.

\textsuperscript{129} See articles in \textit{The Times}, 22 December 1995: "Bruised BT braced for MMC inquiry", quoting BT's deputy managing director, Mr Alan Rudge, as saying; "He [the Director General] would have almost absolute power, with no right of appeal to the courts or other disinterested body for impartial analysis if he gets the facts wrong or his decision is mistaken... Any extension of these powers should be a matter for Parliament."; Letter from Sir Kenneth Warren to \textit{The Times}, 28 December 1995: "Telecom Regulator's crossed lines"; Letter from John Butler, Director of Regulatory Affairs at BT to \textit{The Times}, 10 January 1996 "BT regulation".

\textsuperscript{130} See article in \textit{The Sunday Times}, 4 February 1996: "BT lobbies investors over Oftel shake-up."
and referred to the published draft guidelines (which did not envisage such a use of the regulator's discretion) as evidence supporting this lack of any sinister motive on its part. 131

(ii) Some Philosophical Considerations

Some sharemarket analysts were also predictably critical of the OFTEL proposal, claiming in effect that it represented a shift in the ground rules for investors and that it would drastically reduce the return to BT's shareholders from the present rate of return of about 19 per cent to between 9 and 13 per cent. 132 On the other hand, it might equally well be argued that no company ought to be entitled to rely on a permanently entrenched monopoly position, or the continued ability to employ anti-competitive practices, for the maintenance of an excessively high rate of return at the expense of other stakeholders in the regulatory process, particularly consumers.

In jurisdictions which have stronger competition laws, like the United States, such a proposition would be taken for granted. The same is likely to hold true for those member states of the European Community which have fully assimilated EC competition law into their domestic competition legislation. Furthermore, it should not have required too penetrating a crystal ball to enable BT's shareholders to predict that an era of increasing competition in telecommunications, arising as much from technological innovation as from regulatory intervention, would be likely to reduce the comparative level of BT's profits (and therefore the return to its shareholders) in the longer term in any event.

If BT cannot earn an adequate return unless it has the freedom to engage in anti-competitive market practices then the writer's argument, viewed in this light, becomes difficult to refute. In a truly competitive telecommunications market a company such as BT would be obliged to undertake new investment and to price its services at a level

131. These subtleties of the BT argument were explained to me by Mr Paul Ryan of OFTEL in the course of my interview with him, supra note 79.

132. See for example article by Pennington in The Times of 22 December 1995: "Cruickshank lays down the law."; article in The Independent, 3 February 1996: "Watchdog's plan could halve profits, BT warns."
which reflected consumer demand for them, which is nothing more nor less than how matters should be. The fact that some BT shareholders might chose to believe they have an open-ended right to high returns derived from a company in a dominant position in the industry should properly be regarded as an erroneous conception.

(iii) Possible Alternative Approaches

An alternative approach to the issue of anti-competitive conduct might be to provide for a formal preliminary hearing into allegations of such behaviour, to be followed by a subsequent substantive hearing if necessary, as in the case of the CAA regime in this area.\(^{133}\) Such an approach would require the establishment of formal hearing procedures by primary or delegated legislation and might be unduly cumbersome in the telecommunications area. The OFTEL proposal sought to achieve the same goals by a simpler mechanism. The regulator left open the nature of the investigatory mechanism to be employed under the proposed new condition, although something short of a full hearing was envisaged by OFTEL. The courts might well have a role to play here in ensuring fairness of procedure to affected parties in the hopefully unlikely event that this proved to be necessary.

Another variant on the approaches adopted in this area is illustrated by the standard licence conditions adopted by the Rail Regulator in relation to certain forms of unacceptable market behaviour. Existing rail passenger operating licences have commonly contained a condition allowing the Rail Regulator to serve an investigation notice where the regulator had reason to suspect the existence of practices such as the setting of predatory fares and exclusionary behaviour. Where the licence holder was in a dominant position and engaged in such activities the Rail Regulator could issue a further notice specifying compensation which the licence holder ought to pay in respect of the conduct in question.\(^{134}\) Again, the issue of what kind of hearing requirement, if any, might be involved in such a determination has been left open.

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133. See part 7.6.2(i) of chapter 7.

134. See for example Condition 6 headed "Predatory Fares and Exclusionary Behaviour" of the Passenger Licence granted to InterCity West Coast Limited and dated 28 April 1995.
To date these powers have not been exercised by the Rail Regulator. The relevant licence conditions have been framed in more restrictive terms than the proposed OFTEL condition. However, they do reflect a similar enforcement approach in that the Rail Regulator has a discretion to order compensation if in his opinion the licence holder has infringed the terms of the condition. The Rail Regulator's approach is therefore substantially similar to that advocated for by OFTEL. Apparently the other utility regulators are also looking closely at the OFTEL initiative, although their adoption of a similar proposal may be hindered by the individual statutory framework and the nature of the competitive regime in the particular utility sector.

Finally, and not unimportantly, a general condition relating to anti-competitive behaviour did have some existing precedent in the telecommunications area. The licence conditions governing the activities of international resale operators, including BT's subsidiary Concert, and the large US operators AT&T and Sprint, contained a provision that was similar in effect to the proposed OFTEL condition in the domestic market. This licence condition applied where the Director General believed that any act or omission of the licensee was likely to lead to competition in the provision of the particular telecommunications service being restricted, distorted or prevented. Where it appeared to the Director General that such circumstances existed a determination to that effect could be issued requiring the licensee to remedy the situation in a prescribed manner. The Director General had broad powers under the licence condition to impose appropriate remedial steps on the licensee.

To date the above licence condition has not been used by OFTEL. However its existence indicated that powers of this nature were not as novel as BT might choose to portray, especially given that one of BT's own subsidiaries had such a provision in its reseller's licence.

135. In the course of my interview with him, supra note 79, Mr Paul Ryan indicated that the Director General of Gas Supply was very interested in the OFTEL initiative in this area but was constrained from proceeding along similar lines by the more restrictive legislative framework contained in the Gas Act 1986 and the Gas Act 1995.

136. See Condition 10 of the standard form of International Resale Licence (included pursuant to the authority conferred under s 7(5) and 7(6) of the Telecommunications Act 1984.) I am again grateful to Mr Paul Ryan of OFTEL for drawing this provision to my attention.
The early part of 1996 was characterised by a continuing impasse between BT and OFTEL over the proposed licence condition. This dispute was exacerbated by differing assumptions between the parties concerning the expected growth in the local call market. BT estimated that growth in this market would diminish to a rate of 2% per annum over the period 1997-2001. These figures differed markedly from those of OFTEL, which predicted a growth in the volume of local calls by a figure which OFTEL believed could be up to 7% per annum. The significance of these figures was that they were directly relevant to the argument between BT and the regulator over the likely need for more stringent provisions dealing with anti-competitive conduct.

BT made further representations to OFTEL during the first half of 1996, including submissions made in response to the consultation over OFTEL's statement of 3 June 1996 concerning pricing of telecommunications services. In its final response to the new regulatory package, delivered to OFTEL at the end of June 1996, BT affirmed its opposition to the fair trading condition, particularly in relation to the absence of any right of appeal. In an open letter to BT dated 18 July 1996 OFTEL enclosed the proposed final draft of modifications to BT's licence incorporating retail price control arrangements which were to apply from August 1997 together with a revised version of the condition relating to anti-competitive behaviour.

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137. For a useful summary of the dispute over local call volumes see article by Mary Fagan in The Independent, 9 April 1996: "BT and Oftel locking horns over local calls".


139. See article in The Times, 2 July 1996: "BT stands ground in Oftel battle".

140. This letter was made public by OFTEL and a copy with the annexures to the letter was attached to OFTEL press release 42/96 dated 18 July 1996, "Price Control and Fair Trading". I am grateful to Mrs Anna Walker, Deputy Director General of OFTEL, for bringing these matters to my attention in the course of a helpful interview with her at OFTEL on 31 July 1996. In its press release OFTEL made it clear that the proposals as to retail price control and anti-competitive behaviour were part of a package and had to be treated as such by BT: "The proposals are substantially the same as those set out in OFTEL's Statement of 3 June on which OFTEL consulted. Some changes have been made to the Fair Trading Condition to incorporate into the Condition some of the procedures OFTEL had indicated it proposed to adopt. If the proposals will now need to be considered by the BT Board. OFTEL expects a response by 2 August. OFTEL has made clear that the proposals are indivisibly linked: BT cannot accept one element of them without the other. If BT rejects the proposals, these issues will be the subject of a reference to the Monopolies and Mergers Commission (MMC)."
The amended version of the fair trading condition which was enclosed with OFTEL's letter of 18 July incorporated several changes, including an obligation on the Director General to publish reasons for the making of provisional enforcement orders in addition to final determinations, tighter provisions relating to the use of the proposed guidelines and a requirement to publish procedures to be used in investigations together with details as to the use of expert advisers. OFTEL also confirmed that its intention was to incorporate the condition generally into the licences of other telecommunications operators.141

The BT Board finally met on 2 August 1996 to consider the OFTEL proposals on retail price control and the new fair trading condition. An interview with the Deputy Director General of OFTEL shortly prior to this meeting revealed that OFTEL was genuinely uncertain whether BT was likely to accept the proposed package.142 In the event, the BT Board did decide to settle its differences with OFTEL, just several hours in advance of the Director General's deadline. The Board agreed to OFTEL's proposal to reduce prices by 4.5% per annum in real terms and also to the revised fair trading condition (a copy of which is annexed as Appendix II to this chapter). However BT indicated that a court ruling would be sought on whether the changes were intra vires in terms of the

141. See page 3 of the OFTEL letter, *ibid.* "OFTEL has considered carefully the representations made by BT and others on the Condition. In the light of these, I have decided to amend the Condition in a number of respects. The effect of these amendments is essentially to clarify OFTEL's stated intentions or to incorporate within the licence itself, for the avoidance of doubt, some of the procedures OFTEL is proposing to adopt."

142. Interview with Mrs Anna Walker of OFTEL on 31 July 1996, *supra* note 140. Mrs Walker explained that OFTEL viewed the proposed condition as being central to its regulatory strategy in a comparatively dynamic industry environment. The absence of such a condition meant that there was little incentive on the part of BT and other operators to consider the consequences of undesirable market practices. While BT appeared to be genuine in wanting an appeal mechanism added to the proposed condition, Mrs Walker thought that it was debatable whether BT would risk undertaking an MMC review given the depth of feeling in the industry amongst BT's competitors and BT's intransigence in other areas, such as the long delay in working towards obtaining number portability. While it was possible that an MMC review could be settled part way through if there was agreement on the desired policy and the MMC considered that the suggested resolution of the issue was in the public interest, such an outcome was by no means guaranteed. Furthermore the addition of an appeals procedure to the proposed licence condition would require amending legislation which might not necessarily attract the requisite political support. Mrs Walker thought that while, in the longer term, competition in the industry was likely to increase considerably, this might not necessarily lead to OFTEL's role diminishing over time as the dominant operator might be tempted to respond by taking a less accommodating stance on issues such as interconnection.
regulator's statutory powers. Given that a period of six weeks' consultation would be necessary in relation to the changes to BT's licence, the fair trading condition was to take effect from 31 December 1996 and the price controls would commence in August 1997. While the press tended to regard the outcome as a regulatory victory for OFTEL, it seems clear that BT recognised that embarking on an MMC review would serve to put the company in effective limbo for six months to a year at a time when it

143. OFTEL's views as to the scope of its powers in this area are concisely summarised in Annex D to its letter of 18 July 1996 to BT, supra note 140, which summarised the essential aspects of legal advice received by OFTEL on this point. Paragraphs 3-5 of this Annex are of interest in the present context and it is useful to reproduce these as follows:

"3. While the FTA [Fair Trading Act] and the CA [Competition Act] deal with the exceptional circumstances in which regulatory intervention may take place in economic activities that are otherwise unregulated, the 1984 Act provides a special regulatory regime for telecommunications. Regulation is effected through the licences granted under section 7. Pursuant to section 7(5), a licence may include such conditions as the Secretary of State or the DGT considers requisite or expedient having regard to their duties under section 3. Those duties include exercising their functions in the manner which they consider is best calculated to maintain and promote effective competition between persons engaged in commercial activities connected with telecommunications. By section 12 the DGT is empowered, subject to certain conditions including the consent of the licensee, to modify the conditions of a licence granted under section 7. In exercising his functions under section 12 the DGT is subject to the duties under section 3.

4. In performing his functions under section 12 in accordance with his section 3 duties, the DGT is entitled to put forward licence modifications as a means of dealing with anti-competitive practices. Certain types of anti-competitive behaviour are already addressed by conditions of the licence (for example Condition 17 or 20B.15). Neither such existing provisions nor the proposed Condition 18A have the effect of frustrating the FTA or CA regimes.

5. In summary, to focus, as regards anti-competitive behaviour, primarily on the provisions of section 50 of the 1984 Act and of the FTA and CA regimes is to promote those provisions to a position which they do not occupy. In the regulation of anti-competitive behaviour in the telecommunications sector, they are the "long stop", the licence and modifications to it are indeed the first line of defence."

144. See article in The Times, 3 August 1996: "BT settles dispute with Ofel at eleventh hour"; article in The Sunday Times, 4 August 1996: "BT asks courts to block new Ofel powers": "Ofel's lawyers say it is within its authority under the 1984 Telecommunications Act. But under the terms of the agreement hammered out by the two sides on Friday, it will not stand in BT's way as the company seeks a court ruling...If the High Court does uphold Ofel's general power, BT hopes the government will pass legislation to establish a forum for appeal against Ofel decisions. Cruickshank is to appoint a committee of up to eight "wise people" to which BT could appeal, but this will have no executive authority." Details of the timetable for the incorporation into BT's licence of the new fair trading condition, the deletion of obsolete conditions and the new retail price controls were set out in the OFTEL press release 61/96 of 1 October 1996: "OFTEL Makes BT Licence Amendments."
was pursuing fresh strategic initiatives in Europe and the United States through its new chief executive, Sir Peter Blomfield, who had assumed the position in January 1996.145

BT’s High Court challenge to the validity of the new fair trading condition came before the Court on 20 December 1996 on an urgent basis as the new condition was due to take effect on 31 December 1996. The judgment of the Court was given on that day.146

The Court began its judgment by noting the role of the Director General in promoting competition in the telecommunications industry in terms of the Telecommunications Act 1984. It then considered the seven grounds on which BT had sought judicial review of the Director General’s decision to introduce the new condition.147 In response the Director General argued that the first six grounds of BT’s opposition were

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145. See article in *The Times*, 6 August 1996, "Peace pact with Oftel leaves BT free to talk about deals": "Although the new regulatory regime is not to BT’s liking, Sir Peter [Blomfield] is probably secretly pleased with the outcome.Rejecting the regime would have automatically triggered a monopolies inquiry, a process that would have virtually paralysed BT for no less than six months and, in all likelihood, as long as a year. For the first time since January, Sir Peter now has the freedom to make his mark on BT."

146. See *R v The Director General of Telecommunications, ex parte British Telecommunications plc* (unreported, QBD, Phillips LJ and Hooper J, 20 December 1996, judgment of the court delivered by Phillips LJ). (I record here my thanks to Mr Colin Scott of the LSE Law Department for forwarding a copy of this unreported judgment to me when a transcript became available in March 1997.) The case is mentioned in the article by Scott, "Telecommunications - Anti-Competitive Conduct, Licence Modification and Judicial Review in the Telecommunications Sector" (1997) 8 Util LR 120.

147. In summary, these grounds, as recorded at pp 5-8 of the unreported judgment, were as follows:

- Condition 18A (the proposed new fair trading condition) introduced obligations into BT’s licence which exceeded the Director General’s powers under Part II of the 1984 Act, which set out OFTEL’s licensing duties;
- The proposed condition effectively by-passed the role of the MMC and Secretary of State in considering specific amendments to BT’s licence;
- Licence conditions under the 1984 Act had to be "sufficiently specific to enable BT to be certain what they are and what they are not permitted to do" and that the proposed condition was insufficiently precise to fulfill this requirement;
- The proposed condition usurped the statutory roles of the UK competition authorities, including the MMC and Secretary of State and was therefore unlawful;
- The proposed condition enabled OFTEL to interfere in the operations of a licensee’s telecommunications system and was therefore *ultra vires*;
- In exercising his powers under the proposed condition the Director General “may find himself investigating an agreement which is simultaneously subject to investigation by the Director General of Fair Trading under the [Restrictive Trade Practices] Act 1976 and that in as much as the Condition produces this result it is *ultra vires*.”
- The proposed condition was contrary to European Community law and therefore *ultra vires* because it was "calculated to give rise to conflicts between decisions of
misconceived given that Part II of the 1984 Act was intended to cater for the promotion of competition and the powers sought were consistent with this goal. In relation to the issue of EC law, the Director General contended that the proposed condition was consistent with the thrust of European competition law and was therefore not *ultra vires*.

The Court went on to consider the wording and effect of the proposed new Condition 18A. It considered generally that the proposed condition was consistent with the policy and objects of the 1984 Act in promoting competition in the UK telecommunications industry. This provided an answer to most of the first six grounds of BT's opposition. The Court gave particular attention to the issue which it stated had caused it the most concern, namely whether the Director General had circumvented the statutory scheme of the 1984 Act in relation to the functions of other bodies such as the MMC.

The Court considered that the answer to this difficult question lay in the manner in which licence modifications could be imposed on a licensee. Initially a prospective licensee could refuse to accept licence conditions offered to it. However once a licence had been granted rights vested in the licensee and it could only be obliged to accept subsequent modifications to which it was opposed where the MMC so directed. In the present case BT had in fact consented to the new condition provided that it was *intra vires*, an issue which the Court had determined in favour of the Director General. 148

On the issue of EC law BT had argued that the risk of the Director General's decisions conflicting with those of the European Commission or the European Courts led to the conclusion that the proposed condition was *ultra vires* given the absence of any

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148. As the Court put it at p 31 of its judgment: "At the outset, an applicant for a licence is not bound to accept the conditions proposed by the Secretary of State or the DGT. If the conditions are unacceptable the applicant can decline to proceed. Once, however, the licence has been granted, rights vest in the licensee. Any subsequent modification of that licence will affect those rights and may have serious consequences, having regard to action taken by the licensee in the exercise of them. It is in the latter, and not the former, circumstances that the 1984 Act provides that, in the absence of consent, a modification can be forced on the licensee only where the MMC determines that the public interest so demands. Where there is consent there is nothing objectionable under the 1984 Act in allowing the DGT to decide what conditions are required in the public interest having regard to those matters which his duties require and permit him to consider, subject always to the overriding power of veto of the Secretary of State."
mechanism to resolve such a conflict. The Court had little sympathy with this argument given that the Director General had endeavoured to make the wording of the new condition consistent with that of Articles 85 and 86 of the Treaty of Rome, dealing with anti-competitive behaviour, so that, far from giving rise to inconsistency, the new condition was likely to further the objects of EC competition law in this area. Accordingly BT's application was dismissed, although the court granted it leave to appeal. (BT has decided not to appeal against the judgment.)

The judgment generally shows a willingness on the part of the court to construe the Director General's powers under the 1984 Act in a flexible and purposive manner so as to give effect to the regulatory goal of imposing effective controls on anti-competitive behaviour by licensees. In approaching this task, the court was at pains to interpret the statutory scheme in such a way as to accommodate the proposed condition and was not impressed by attempts to raise technical issues of EC law in an area where the Director General had sought to harmonise the proposed condition with existing European competition law.

It is interesting to note that the Court was only able to answer BT's argument concerning the role of the MMC in licence modifications on the grounds that BT had consented to the proposed condition, subject to the court's ruling on its lawfulness. This may cause difficulties for OFTEL in seeking to insert the proposed condition in the licences of other telecommunications operators. If other operators had refused to consent to the proposed modification then it would seem that an MMC reference would have then become necessary in each case. Given that clause 18A.1(a) of the proposed licence condition was directed at controlling abuse of a dominant position within the UK telecommunications market other licensees might not have felt as strongly about the condition as did BT. In any event, these theoretical difficulties did not materialise. OFTEL issued several papers in March 1997 setting out a detailed programme for

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149. As the Court noted at pp 34-35: "In fact there is built into Condition 18, in the form of 18A.3, provisions aimed at ensuring that the DGT will adopt an approach to the language of the Condition that mirrors the correct approach under Community law. So far as Community law is concerned, we think that the effect of Condition 18A is wholly beneficial. To suggest that the effect of Community law is to strike down Condition 18A as ultra vires, because it contains no machinery to avoid the potential conflict postulated by Mr Barling, albeit that it is hard to see what machinery could achieve this, is startling. Our conclusion is that Ground 7 is devoid of merit."
implementing the new regulatory regime by inserting the fair trading condition in licences generally and also adopting the accompanying guidelines.\textsuperscript{150}

9.7 \textbf{The Design of Regulatory Rules - Some Lessons from the OFTEL Initiative.}

9.7.1 \textbf{The Regulatory Process in UK Telecommunications}

In approaching this part of the chapter it is important to appreciate some of the essential differences in regulatory approach between US and UK practice. The US administrative process in the regulatory area is based on the use of general statutory discretions which confer wide subjective powers on the independent regulatory agencies. These discretionary powers are, however, tempered by the procedures in the US APA, particularly in relation to consultation and the need for formal hearings in certain circumstances.\textsuperscript{151} Although the practice of US rulemaking has been praised by some commentators as a means of structuring and limiting bureaucratic discretion, and thereby rendering the administrative state more democratically legitimate, the vesting of extensive rulemaking powers in the US regulatory agencies has also been recognised as having created a process requiring extensive external checks and balances, not least because rule making procedures are essentially legislative in nature.\textsuperscript{152}


\textsuperscript{151} See part 6.4.2 of chapter 6.

\textsuperscript{152} See for example Lowi, \textit{The End of Liberalism} (Norton, New York, 2nd ed, 1979) at pp 303-304, who has argued that the administrative process could be approved by the earlier use of agency
These considerations have resulted in various constraints being imposed on agency activity in the US context.\(^{153}\) These have included external political controls through the Office of Management of Budget (such as the imposition of cost-benefit analysis of new rule making initiatives) and Congressional control through the funding process and through legislative amendment. Judicial control through the process of judicial review is also a significant part of the US regulatory process, as was noted in chapter 6.\(^{154}\) Finally, and not to be underestimated, the need for agencies to justify their rulemaking activities in theoretical terms, both from an economic and scientific perspective, has led to the development of considerable internal expertise in US regulatory agencies in these areas, which has led to a form of self-imposed check on regulatory activity.

By way of contrast, the UK regulatory system has few of these external constraints. In the case of telecommunications, the statutory framework confers a wide discretion on the regulator to pursue the prescribed statutory goals as he sees fit.\(^{155}\) To this extent, the broad discretionary powers conferred by legislation on regulatory bodies in both the United States and the United Kingdom are similar in nature. However, in the United Kingdom, external political controls are more limited and if they exist at all are exercised in a much more subtle fashion. The process of judicial review is of more

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153. See parts 6.3.5 to 6.3.6 of chapter 6. See also Bryner, *Bureaucratic Discretion* (Pergamon Press, New York, 1987), p 3, who observed: "First, legal procedures outlined in the Administrative Procedure Act and in specific enabling legislation serve as a primary constraint on administrative discretion and have become part of an elaborate and complex system of administrative law that seeks to assure that agency actions are bound by legal, procedural requirements. Second, scientific and economic decision rules and analyses have been emphasised as a way to give shape to agency decision making, and to provide limits on administrative activity. Third, oversight efforts by Congress and presidents and their staffs have sought to ensure that bureaucracies be accountable to political and electoral forces."

154. See part 6.5.3 of chapter 6.

155. See for example ss 3(1) and 3(2) of the Telecommunications Act 1984 which confer discretionary powers on the Director General of Telecommunications to implement the regulatory regime "in the manner which he considers is best calculated" to promote the objects of the legislation.
limited scope than in the United States and there are of course no mandatory administrative procedures in place along the lines of the US APA.

The latter aspect may be of lesser significance given the voluntary adoption by OFTEL of extensive consultation procedures and its conscious efforts to involve a wide range of parties in the regulatory process. Similarly the process of MMC review in respect of licence amendments, though limited in scope, nevertheless acts as a limited form of constraint on the regulator's freedom of action. The adoption of guidelines in relation to the Director General's discretion can also be viewed as a limiting factor, although these are ultimately not binding on the regulator. Nevertheless, at the end of the day, independent regulators such as OFTEL can, at least in theory, operate with fewer restrictions than their US counterparts. Given that the US independent regulatory agencies are often thought to typify the concept of independent regulation (and certainly pioneered it) such a position might be thought to be somewhat anomalous. The next part of this chapter examines some aspects of the regulatory powers of OFTEL in further detail in order to illustrate these aspects further, with particular emphasis on the new licence condition in respect of anti-competitive behaviour.

9.7.2 The Balance Between Rules and Discretion in the New OFTEL Licence Condition

As was noted in chapter 4, balancing the use of rules and discretion in this area is not an easy task.\textsuperscript{156} As the discussion in that chapter showed, factors other than legal ones provide an important part of the context in which discretionary decision making operates and a variety of external factors can impact on administrative decision making.

It is instructive to apply these considerations to the case of OFTEL. While on its face the Director General's discretion appears unfettered, in practice significant regulatory decisions are taken after extensive internal consultation and in fact are the product of an

\textsuperscript{156} See the discussion in part 4.8 of chapter 4.
informal consensus of opinion among officials, drawing on the opinions of staff from a number of different sections or divisions within the organisation.\footnote{157}

In the case of OFTEL the organisational structure is divided into a number of different areas of expertise, covering activities such as licensing, economics, consumer affairs, network competition and enforcement matters.\footnote{158} The use of advisory committees also provides an additional dimension in this area.\footnote{159} Political influences may also bear on the regulator's discretion, although these are likely to operate behind the scenes rather than in a more transparent fashion.\footnote{160} (However, a controversial regulatory decision which tended, for example, to undermine the foundations of privatisation in a particular area would no doubt attract close political interest.) While the regulator therefore has a broad statutory discretion,\footnote{161} this is constrained in practice by a number of external factors which are not immediately apparent from a perusal of the legislative framework.

In relation to the proposed licence condition on anti-competitive behaviour, similar constraints apply. An initial complaint from an operator affected by alleged anti-competitive conduct would be directed to the licensing branch of OFTEL which then carries out an initial investigation of the matter. This is followed by a preliminary reply to the complainant within 15 working days indicating whether OFTEL believes there is a substantive case to answer, describing the nature of the initial investigations carried out and advising whether any further action is in contemplation.\footnote{162} If a further investigation is warranted regular reports are made to the complainant.\footnote{163} OFTEL has affirmed that it intends to take steps to improve the transparency of its enforcement procedures.

\footnote{157} See part 8.5.4 of chapter 8.


\footnote{159} For a discussion of the role of the OFTEL Advisory Committees see \textit{OFTEL 1994 Annual Report, supra} note 5, pp 77-97.

\footnote{160} See part 7.6.1(iii) of chapter 7.

\footnote{161} See the text accompanying note 155, \textit{supra}.

\footnote{162} See \textit{Doing Business with OFTEL, supra} note 12, chapter 4, particularly paragraph 4.24; Information on enforcement procedures supplied by Mr Paul Ryan of OFTEL, \textit{supra} note 79.

\footnote{163} \textit{Ibid} paragraph 4.25.
casework and will be implementing a review of casework procedures and information systems.164

While any significant regulatory enforcement action requires the ultimate approval of the Director General and will be taken in his name, such action will only follow extensive internal consultation and reporting. The fact that under the new licence condition, the Director General has agreed to determine issues of alleged anti-competitive behaviour by having regard to general principles of competition law and the scope and interpretation of the competition rules contained in the EC Treaty.165 These are matters which necessarily involve the application of economic principles, and illustrate the influence of economic factors on regulatory decision making.

To this extent, the practical operations of regulatory bodies such as OFTEL are not dissimilar to those of the US regulatory agencies, which operate under a commission structure. Discretionary decision making by OFTEL under the new licence condition would clearly therefore be of a collective nature in all essential elements. The proposed adoption of guidelines in relation to the new condition, while these are not strictly binding on the Director General, also represents a positive step in terms of ensuring the transparency of the regulatory process.

9.7.3 Issues of Rule Design as Illustrated by the New Licence Condition

The new OFTEL Licence Condition relating to anti-competitive practices, which confers a general discretionary power on the Director General, to be exercised in the light of detailed guidelines, represents one possible approach to the choice of rule type in the regulatory area. Other approaches can however be identified and considerable academic analysis has been carried out in this area.166 This literature has identified a number of discernible characteristics of different rule types.


166. See for example Kydland and Prescott, "Rules Rather than Discretion: The Inconsistency of Optimal Plans" (1977) 85 J Pol Econ 473 (in which the authors undertake a theoretical analysis
A rule based on the detailed specification of individual instances (such as the initial form of BT's Licence) lends itself to certainty and transparency of operation, in that both the regulator and the party affected by the regulatory rules are able to assess the likelihood of a certain course of action infringing the rule. On the other hand, from a regulatory perspective, such an approach entails some enforcement difficulties. A questionable course of conduct has to be related to a specific rule breach and the discussion earlier in this chapter has shown that there is considerable danger of particular forms of conduct "falling between the cracks", especially where a novel situation or a new technological innovation is concerned.\footnote{167}

On the other hand, a regime containing a substantial discretionary element suffers from the converse difficulties. Apart from political and constitutional objections based on the level of discretionary power that ought properly to be exercisable by officials of limited accountability to the democratic process, difficulties of interpretation also arise. The essential problem here is whether the regulated party's conception of the way in which the regulator's discretion will be exercised in a particular case does in fact match the actual approach adopted by the regulator. While provisions of this type are conducive to breadth of enforcement, in that the regulator has considerable power to set the rules of the game, there is also the possibility of potential unfairness or the making of unreasonable or irrational decisions. Under this model, therefore, comparative ease of enforcement needs to be balanced against greater uncertainty of operation and a lesser degree of predictability.

Many of the difficulties inherent in both of these extremes can be minimised or avoided by a \textit{via media} which combines elements of both approaches. In many ways the new OFTEL condition represents a commendable attempt at such an approach. While the new condition confers a broad discretion on the Director General, this discretion is to be exercised having regard to the guidelines. In addition, the Director General must also have regard to applicable competition law principles, to the approach of the

\footnote{167. See the discussion in part 9.6 of this chapter.}

European Court of Justice, to decisions of the EU Commission on the application of the competition rules contained in the EC Treaty and to relevant pronouncements of the Director General of Fair Trading or reports of the MMC.

The proposed enforcement structure also operates as a check on the regulator's discretion. Before making an Initial Determination or Final Determination the Director General must give the licensee a period within which it can make representations, either orally, in writing or both, in response to the determinations. Reasons for the determinations must be given, which assists an affected party to seek judicial review in an appropriate case. As has been noted above, detailed guidelines have been promulgated and while these are not strictly binding on the Director General as a matter of law, they are likely to be of considerable persuasive influence. These structural features assist in moderating the wide discretionary powers of the Director General.

The move towards regulatory rules drafted in a more general fashion and conferring a general discretionary power on regulators in respect of anti-competitive behaviour has been noted above in relation to the CAA and the Rail Regulator, and also in relation to the standard conditions of international re-sellers' licences in telecommunications. Black has noted a similar initiative in the financial services area, reflected in the adoption of a handful of "Core Principles" by the Securities and Investments Board from 1990 onwards.

Some reflection serves to illustrate that the OFTEL initiative bears some resemblance to the financial services regime. While the regulatory structure in the telecommunications industry differs considerably from that which is applicable to

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168. See clauses 18A.4 to 18A.6 of the OFTEL version of the proposed licence condition.

169. See the discussion of the guidelines in part 9.6.8 of this chapter.

170. See the text accompanying notes 133-136, supra.

171. See Black, supra note 166, pp 104-105: "The Principles are relatively imprecise and vague; they are purposive, and so provide greater flexibility in their application. The SROs' rules are far more detailed, so providing greater certainty and predictability as to the rules' application in a particular instance. The Principles override these rules, so that issues of application and interpretation are to be resolved in the light of their provisions. The combination of rules of different structure, detailed and general, is thus aimed at aiding the regulated by providing both certainty and flexibility. The Principles also aid the rule maker in that they reduce the pressures for precision which arise out of a fear of creating gaps in the rules."
financial services (which is based around a more complex two-tier structure), the use of both general and specific regulatory rules is a common factor. In the case of the new licence condition, the Core Principles in the financial services area correspond with the Director General's general discretionary powers in respect of anti-competitive conduct. The SROs' rules have their counterpart in the detailed guidelines proposed by OFTEL, though the latter are non-binding as a matter of law.

A purposive approach is also evident under both regimes. It is noteworthy that the OFTEL condition is designed to extend to conduct which "has or is intended to have or is likely to have the effect of preventing, restricting or distorting competition where such act or omission is done in the course of, as a result of, or in connection with, providing telecommunications services...".172 The OFTEL condition and its accompanying guidelines therefore reflect current initiatives in other areas of UK economic regulation and represent, at least to this writer, a reasonable compromise between the demands of certainty and flexibility.

9.7.4 A Rule Making Regime for UK Telecommunications?

It is instructive to reflect upon the extent to which the published OFTEL guidelines exhibit some of the characteristics of a rule making regime in the UK telecommunications industry. While the proposed guidelines are non-binding they are to be adopted after OFTEL has undertaken industry consultation and will be subject to revision as the telecommunications market develops. OFTEL has suggested that changes will arise in this area either from particular enforcement action which highlights the need for particular amendments, from changes in the relevant case law and in circumstances where particular cases have made it necessary to depart from previous decisions, giving rise to the need to change the precise wording of the guidelines.173

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172. See clause 18A.1 of the new licence condition.

173. See the December 1995 OFTEL Statement, supra note 89, paragraph 3.7.
Some aspects of this regime, particularly the emphasis on industry consultation, resemble rule making by federal regulatory agencies under the US APA. However, the fact that OFTEL need not follow the published guidelines where the Director General considers that such a course is necessary represents a significant area of divergence from US regulatory practice. In the United States failure by a regulatory agency to adhere to adopted rules is, in practice, one of the principal areas through which agency action is controlled by the process of judicial review.\textsuperscript{174}

The scope for the corresponding exercise of judicial review in the UK context is limited by the fact that the Director General is not strictly bound by the guidelines and has a largely unfettered discretion under the Telecommunications Act, providing of course that the regulatory action in question can be related to the objects and purposes of the Act. However, it may be open to a UK court to characterise a decision of the Director General in this area as being unreasonable or irrational where it runs contrary to the direct thrust of a guideline and the grounds for divergence from the published guideline are not adequately or convincingly explained in the reasons given by OFTEL for the decision. This would seem to be an area in which the Director General will need to exercise considerable care in the event that a departure from the published guidelines is viewed by him as being necessary in any particular case.

One other aspect which is likely to impact upon the rule making characteristics of UK telecommunications regulation is the EC movement towards a single telecommunications market and the consequent need for standardisation of procedures among the Member States. At present a draft EC directive is under consideration which seeks to introduce a system of class licences, under which particular categories of telecommunications services would be governed by standardised licence conditions.\textsuperscript{175}

If such a proposal is implemented this may lead to the effective imposition of standardised licence conditions on the UK telecommunications industry. Such a

\textsuperscript{174} See part 10.7 of chapter 10.

\textsuperscript{175} See Proposal for a Directorate of Telecommunications, Draft Directive 95/0282 (COD), Brussels, 14 November 1995, COM (95). I am again grateful to Mr Paul Ryan of OFTEL for bringing this draft directive to my attention.
If such a proposal is implemented this may lead to the effective imposition of standardised licence conditions on the UK telecommunications industry. Such a development might require some legislative amendment to the UK Telecommunications Act 1984 as the Director General's discretion would then be subject to the constraints imposed by the EC regime. However, at present, while the UK regime of telecommunications regulation exhibits some of the characteristics of US rule making, it cannot be said to constitute a comprehensive rule making regime.\(^{176}\)

While the Director General does not have general rule making powers under the Telecommunications Act, he can initiate the process of licence amendment, subject to the review powers of the MMC in this area. The streamlining and standardising of licences which will be envisaged as resulting if the OFTEL proposal is adopted can also be viewed as a limited rule making initiative, as the discussion in the following part of this chapter suggests.

Finally in this part, it is of interest to compare the OFTEL licence amendment procedure, which is in reality a limited form of rule making, with the corresponding rule making procedure under the US APA. This has been done in diagrammatic form in Appendix III to this chapter, which illustrates that the OFTEL and APA regimes bear more than a passing similarity in structural terms. Some obvious distinguishing features are the role of the MMC and the Secretary of State (following an MMC review) under the OFTEL procedure. While the MMC can recommend licence changes pursuant to its review powers, MMC decisions are not strictly binding on the regulator, although to date MMC determinations have largely been followed by UK regulators as a matter of convention. The UK consultation regime undertaken by OFTEL is conducted on a less formal basis than is the case under the statutory rule making requirements in the US APA. Also, while the judicial review option exists in

\(^{176}\) The Director General does have limited powers to make regulations prescribing standards of performance in relation to the provision of telecommunications services under ss 27A and 27B of the Telecommunications Act 1984, as inserted by the Competition and Service (Utilities) Act 1992.
both jurisdictions its use is more widespread in the United States, as has already been noted.

9.7.5 The Influence of Industry Structure on Rule Design

It will be apparent from a consideration of the factors underlying the new OFTEL licence condition that issues of industry structure are intimately bound up with the design of regulatory rules in UK economic regulation and indeed generally. OFTEL itself has linked the need for the new condition to the fact of increasing competition in the UK telecommunications market. This has led to the perceived need for a transition from intrusive regulation based on detailed and inflexible rules to a regime based on a more flexible approach and which can lead to more effective enforcement in a competitive market structure. It is envisaged by OFTEL that this process will in turn result in a greater degree of licence standardisation by reducing areas of disparity between the licences of individual telecommunications operators.177

While at first glance it may appear paradoxical that discretionary powers contained in licence conditions can effectively lead in the direction of a rule making regime through a progressive process of licence standardisation, such a result is perhaps not as unusual as it first appears. Although the new condition is designed with a deterrent element in mind, it is also intended to streamline existing licences by replacing detailed conditions with a more flexible and responsive enforcement regime.

In an increasingly competitive telecommunications market, an incumbent monopolist may be tempted to preserve its declining market share by resorting to anti-competitive behaviour of various kinds. A discretionary regulatory approach such as that which is now in place may prove to be the most successful means of countering such tactics. In a truly competitive market, intrusive regulatory control in areas such as pricing and service may be of lesser significance, but the need for effective control over anti-competitive market practices is likely to remain and perhaps even increase.

177. See the discussion in the text accompanying note 114, supra.
The degree of competition in a particular market is therefore a factor which directly influences the design and thrust of regulatory rules. In a competitive environment regulatory attention is likely to move away from controlling traditional areas of monopoly power to ensuring that unfair practices do not persist in the market.

Economic factors also influence the design of regulatory rules. A dominant supplier will be likely to favour a regulatory rule which will assist in preserving its dominant position for as long as possible, as the above discussion of the BT alternative rule has suggested. Such a party might therefore not find lengthy and cumbersome enforcement procedures to be anathema to it. On the other hand, a regulatory body will favour a rule which gives the greatest regulatory return for a given degree of expenditure and level of application. Such preferences can be seen in the OFTEL initiative, which combines a flexible approach based on regulatory discretion while seeking to avoid becoming involved in the possibly protracted MMC review procedure.

The task of assessing the optimal precision of regulatory rules and devising a regime which reflects this assessment is by no means an easy one, as the theoretical discussion in chapter 4 has shown. Chapter 11 examines in more detail the correlation between discretionary regulatory powers and the use of consensual procedures in economic regulation. That discussion will seek to illustrate that a measure of vagueness arising from discretionary powers may in fact serve a useful purpose by encouraging the use of negotiated or consensual regulatory processes. Where there is some measure of uncertainty as to a regulatory outcome (which will often be the case where the regime is based on a large discretionary element rather than solely on rules), the parties may be unwilling to risk an unfavourable outcome where this can be avoided by employing consensual procedures.

The new OFTEL regime is innovative in nature and if it survives in the longer term in its present form and becomes incorporated into telecommunications licences generally it will be of interest to monitor its ongoing effectiveness. In the meantime we are left

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178. See part 4.8 of chapter 4.
to consider the application, in the context of dominant telecommunications operators, of Balzac's perceptive observation that behind every great fortune lies a great crime.
APPENDIX I

COPY OF BT VERSION OF FAIR TRADING CONDITION DATED 9 NOVEMBER 1995 AND OFTEL VERSION OF 14 NOVEMBER 1995

DRAFT

EFFECTIVE COMPETITION
ALTERNATIVE LICENCE CONDITION:

1(a) If:

(i) it appears to the Director that the Licensee is engaged in anti-competitive behaviour or has engaged in anti-competitive behaviour and is likely to do so again, so that the Director should exercise his functions under the Fair Trading Act, the Competition Act or sections 12 to 15 of the Telecommunications Act, and

(ii) the Director is satisfied that any person will suffer serious and irremediable loss as a result of that behaviour if he fails to take prompt remedial action and that any such loss will significantly outweigh any loss to the Licensee and any detriment to the users of telecommunication services in the United Kingdom resulting from that remedial action,

the Director may, if he considers that it is in the public interest, give to the Licensee a direction under this condition.

(b) The Director shall not make a direction under this condition unless he has first given to the Licensee a notice

(i) specifying the behaviour ("the relevant behaviour") which appears to him to be anti-competitive and why he is satisfied as to the things mentioned in a) ii) above, and

(ii) specifying such period as the Director considers reasonable for the Licensee to make representations, taking account of the circumstances of the relevant behaviour and its likely effect

and the Director has considered any representations made by the Licensee and informed the Licensee why he has accepted or rejected them.

2(a) A direction under this condition may require a Licensee to terminate, or to refrain from doing, the relevant behaviour or, where the relevant behaviour consists in failing to do something, to do that thing.
(b) The Licensee shall comply with a direction given under this condition.

3(a) A direction under this condition shall cease to have effect:

(i) if the Director gives written notice to the Licensee or

(ii) seven days after the Licensee has given notice in writing ("expiry notice") to the Director

(b) The Licensee may give an expiry notice if:

(i) within [42] days of making the direction the Director has neither:

   (aa) made a competition reference, a monopoly reference or a licence modification with a view to regulating or preventing the relevant behaviour nor

   (bb) accepted undertakings from the Licensee nor

   (cc) agreed with the Licensee a modification to the conditions of this Licence or another licence held by the Licensee or an Associate

(ii) the Director has accepted undertakings from the Licensee or agreed a modification to the conditions of this Licence

(iii) the MMC has reported on a reference made in relation to the relevant behaviour and has not concluded that the matter referred to it operates, or may be expected to operate, against the public interest, or

(iv) [three months] after the MMC has reported on such a reference and has concluded that the matter referred to it operates, or may be expected to operate, against the public interest.

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1 This allows the Licensee to agree with the DG that the direction will not terminate automatically if constructive discussions are progressing.
2 May need to differentiate between Competition Act, which has built-in timescales, and T. Act.
3 i.e. DG has failed to follow it up
4 This would dispose of the issue
5 The Licensee is free from further process
6 This concludes the process
MAINTENANCE OF EFFECTIVE COMPETITION: PROPOSED NEW LICENCE CONDITION

"Maintenance of Effective Competition"

XA.1 The Licensee shall not do any thing, whether by act or omission, which has, the object or the effect of preventing, restricting or distorting competition in relation to any commercial activity connected with telecommunications, where such act or omission is done in the course of, or as a result of, providing telecommunication services, or any particular description of telecommunication service, or running a telecommunication system. For the purpose of this Condition such an act or omission prevents, restricts or distorts competition if it takes the form of:

(i) any abuse by the Licensee, either alone or with other undertakings, of a dominant position in the United Kingdom or in a substantial part of it;

(ii) the making of any agreement, or the carrying on of any concerted practice, with any other undertaking which has the object or effect of preventing, restricting or distorting competition.

XA.2 (a) An act or omission of a kind described in paragraph XA.1 is not prohibited where it has no appreciable effect on competition.

(b) An act or omission of a kind described in paragraph XA.1(ii) is not prohibited by this Condition if the agreement or concerted practice contributes to improving the provision of any goods or services or to promoting technical or economic progress while allowing consumers a fair share of the resulting benefit and does not:

(i) impose on the parties concerned restrictions which are not indispensable to attaining those objectives; and

(ii) afford such parties the ability substantially to reduce competition in respect of the goods or services in question.
(c) This Condition shall not apply to any provision of an agreement insofar as it is a provision by virtue of which the agreement is an agreement to which the Restrictive Trade Practices Act 1976 applies (or would apply but for any exemption under that Act).

(d) This Condition shall not apply to any merger which is a merger situation qualifying for investigation for the purpose of Section 64 of the Fair Trading Act 1973.

XA.3

(a) Any question whether an act or omission (whether or not it has ceased) is prohibited by this Condition shall be determined by the Director.

(b) Whether any such act or omission is prohibited by this Condition shall be decided in accordance with the general rules of directly applicable competition law, in particular those laid down by the European Court of Justice on the scope of the competition rules contained in the EC Treaty.

(c) In making a determination under this Condition the Director will have close regard to any decision of the EC Commission taken in applying the EC competition rules and will take note of any relevant pronouncement of the Director General of Fair Trading or report of the Monopolies and Mergers Commission.

XA.4

(a) If it appears to the Director that an act or omission of the Licensee is prohibited by this Condition he may make an initial determination to that effect (an "Initial Determination").

(b) Before making an Initial Determination the Director shall send a notice to the Licensee:

(i) saying that he is investigating a possible breach of this Condition

(ii) setting out the reasons why it appears to him that this Condition may be being, or may have been, breached, including any matters of fact or law which he thinks relevant;
(iii) requesting such further information as he may require from the Licensee in order to complete his Initial Determination;

(iv) where appropriate, setting out the steps he believes the Licensee would have to take in order to remedy the alleged breach.

(c) Before making his Initial Determination the Director shall give the Licensee, and any other person whom he considers it appropriate to consult, such period within which to make representations (both orally and in writing) in response to the notice as he considers reasonable in all the circumstances.

XA.5(a) Within 28 days of the Director making an Initial Determination the Licensee may notify the Director that it requires him to make a final determination (a "Final Determination") of the matter and may make to the Director such further representations as it considers appropriate.

(b) The Director shall then determine whether he is satisfied that the act or omission in respect of which the Initial Determination was made is or was prohibited by this Condition.

XA.6 The Director shall notify the Licensee and any other person whom he considers it appropriate to notify of every Initial Determination and Final Determination made by him and of his reasons for making it.

XA.7 This Condition shall not limit or affect in any way the Licensee's obligations arising under any other Condition of this Licence.
APPENDIX II
COPY OF AGREED VERSION OF FAIR TRADING CONDITION - SEPTEMBER 1996

FAIR TRADING

18A.1 The Licensee shall not do any thing, whether by act or omission, which has or is intended to have or is likely to have the effect of preventing, restricting or distorting competition where such act or omission is done in the course of, as a result of or in connection with, providing telecommunication services, or any particular description of telecommunication service, or running a telecommunication system.

For the purpose of this Condition such an act or omission will take the form of:-

(a) any abuse by the Licensee, either alone or with other undertakings, of a dominant position within the United Kingdom or a substantial part of it. Such abuse may, in particular, consist in:

- directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- limiting production, markets or technical development to the prejudice of consumers;
- applying dissimilar conditions to equivalent transactions with other parties, thereby placing them at a competitive disadvantage; or
- making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or
the making (including the implementation) of any agreement, the compliance with any decision of any association of undertakings or the carrying on of any concerted practice with any other undertaking which has the object or effect of preventing, restricting or distorting competition within the United Kingdom.

18A.2(a) An act or omission of a kind described in paragraph 18A.1 is not prohibited where:

(i) it has or would have no appreciable effect on competition; or

(ii) it has or would have no effect on competition between persons engaged in commercial activities connected with telecommunications and it would have no effect on users of telecommunication services.

18A.2(b) An act or omission of a kind described in paragraph 18A.1(b) is not prohibited by this Condition if the agreement decision or concerted practice contributes to improving the provision of any goods or services or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit and does not:

(i) impose on the parties concerned restrictions which are not indispensable to attaining those objectives; and

(ii) afford such parties the possibility of eliminating competition in respect of a substantial part of the goods or services in question.

18A.3 This Condition shall not apply to any provision of an agreement in so far as it is a provision by virtue of which the Restrictive Trade Practices Act 1976 applies to that agreement.

18A.4 This Condition shall not apply to a merger situation qualifying for investigation under the Fair Trading Act 1973.

18A.5 Whether any act or omission is prohibited by this Condition shall be determined:
(a) with a view to securing that there is no inconsistency with the general principles having application to similar questions of directly applicable competition law, in particular those laid down by the Court of Justice of the European Communities on the scope of the competition rules contained in the EC Treaty and block exemptions adopted by the European Commission under Article 85(3); and

(b) having regard to -

(i) any decision taken, or notice issued, by the European Commission in applying the competition rules contained in the EC Treaty and any relevant pronouncement of the Director General of Fair Trading or report of the Monopolies and Mergers Commission; and

(ii) any guidelines on the application of this Condition issued from time to time by the Director.

18A.4 (a) If it appears to the Director that an act or omission of the Licensee is or was prohibited by this Condition he may make an initial determination to that effect (an "Initial Determination").

(b) Before making an Initial Determination the Director shall give a notice to the Licensee:

(i) stating that he is investigating a possible contravention of this Condition;

(ii) setting out the reasons why it appears to him that this Condition may be being, or may have been, breached, including any matters of fact or law which he thinks relevant;

(iii) requesting within a reasonable period laid down by the Director such further information as he may require from the Licensee in order to complete his Determination; and
(iv) where appropriate, setting out the steps he believes the Licensee would have to take in order to remedy the alleged breach.

18A.5(a) Within 28 days of the Director -

(i) making an Initial Determination;

(ii) making a provisional order; or

(iii) giving notice of his proposal to make a final order under section 17(1) of the Act

in respect of the contravention in question, the Licensee may notify the Director that it-

(iv) requires him to make a final determination (a "Final Determination") of the matter;

(v) requires that in making the Final Determination he take into account a report of a body of experts appointed by him to consider the matter ("the Advisory Body").

(b) Before making a Final Determination the Director shall -

(i) give a notice to the Licensee setting out the matters referred to in paragraph 18A.4(b); and

(ii) if the Licensee has given notice under sub-paragraph (a)(v) above, take into account the report of the Advisory Body on the matter.

(c) The Director shall then determine whether he is satisfied that the act or omission in respect of which the Initial Determination was made is or was prohibited by this Condition.

18A.6(a) Before making his Initial Determination or Final Determination the Director shall give the Licensee, and any other person whom he considers it appropriate to consult, such period within which to make representations (both orally and in writing) in response to the notice as he considers reasonable in all the circumstances.
(b) "The Director shall notify the Licensee and any other person whom he considers it appropriate to notify of every Initial Determination and Final Determination made by him and of his reasons for making it; and he shall, if so requested by the Licensee, publish any report of the Advisory Body on the matter, subject to such exclusions as he may consider it appropriate to make of matters of a kind mentioned in section 48(2) of the Act.

18A.7 The Director shall publish a description of his office's procedures for the enforcement of this Condition including the steps taken to ensure that he has access to appropriate independent advice in enforcing this Condition.

18A.8 This Condition shall not limit or affect in any way the Licensee's obligations arising under any other Condition of this Licence nor limit the Director's powers of enforcement under sections 16 to 18 of the Act.
APPENDIX III - RULE MAKING DIAGRAM

AMENDMENT OF UK TELECOMMUNICATIONS

1. OFTEL Formulates Suggested Licence Amendment
2. Consultation Document Issued
3. OFTEL Issues Statement of Policy
4. MMC Recommends Against Amendment
5. Licence Amended
6. MMC Supports Amendment
7. D-G Amends Licence if Secretary of State Does Not Object
8. MMC Review and Decision
9. Possibility of Judicial Review

RULE MAKING PROCEDURE UNDER US APA

1. Agency Formulates Draft Rule
2. Notice of Proposed Rulemaking Published in Federal
3. Agency Receives and Considers Comments
4. Interested Parties are Notified and Can Participate
5. Publication of Final Form of Rule
6. Rule Becomes Effective
7. Judicial Review Successful
8. Possibility of Judicial Review
10. CASE STUDIES IN US ECONOMIC REGULATION

10.1 Introduction

This chapter considers some recent developments in US economic regulation from the perspective of various case studies, particularly involving the work of the state public utility commissions and consumer protection agencies. The empirical research which forms the basis of much of this chapter was undertaken during a two week visit to the United States during January 1996, which included discussions with representatives of the FCC in Washington and with the staff of the public utility commissions and consumer protection bodies in the states of Maine, Massachusetts and New York. This US research yielded a good general appreciation of the work of a range of regulatory bodies, gained from meeting over 20 regulatory officials in total. It served to dispel some common misconceptions about the US regulatory process and highlighted areas in which US regulatory practice differed considerably from the impression which might be conveyed by a theoretical approach based on a reading of statutory materials and academic writing in this area.

The present chapter begins by considering the role of the state public service commissions and state consumer protection bodies in US utility regulation. This part describes recent initiatives in this area, including the move towards "retail wheeling" in a deregulated electricity market, and some of the regulatory implications of these developments. These bodies continue to perform an adjudicative role in the rate setting area, in contrast to the widespread use of administrative rule making in many other aspects of US economic regulation, although the case studies in this chapter will show that the procedures involved have tended to embody a more consensual element in recent years.

The next part of the chapter discusses the use of public hearing procedures in regulatory matters and considers the scope of judicial review of regulatory decisions from a practical perspective. It appeared from research undertaken in this area that use of the remedy of judicial review was still relatively common in the context of US
federal regulation, but was less common at the state level, especially in the area of utility regulation, where the jurisdiction of the federal courts was more limited.

The chapter then moves on to consider current developments in the use of negotiated settlements and consensual procedures. This part of the chapter includes some consideration of the role of state funded consumer bodies, which represent the consumer interest on an organised and coherent basis. Empirical research in this area revealed some interesting aspects to this process. It became evident, for example, that the relationship between the consumer representation bodies and the state regulatory authorities varied from state to state, and that the personalities and individual approaches of the senior lawyers in these bodies exerted considerable influence on this relationship.

In some states there was much co-operation and interchange of views between these two departments. In others, the relationship appeared to be somewhat more strained, especially where major issues of policy divergence were evident. In Massachusetts, for example, the impression was gained that the consumer representation body considered that the state regulatory authority did not always take a sufficiently active role in rate setting issues, resulting in the need for the consumer interest in this area to be more strongly pressed before the commissioners. Underlying this area was the role of third parties, or intervenors, in US state regulatory processes. It appeared that most state utility commissions adopted quite a liberal view of standing in relation to public regulatory hearings, so that disgruntled individuals, often unrepresented, were frequently allowed considerable latitude in presenting their point of view to the state commissioners. This had the potential to prolong and complicate regulatory hearings, and the relationship between the "official" state consumer bodies and other consumer organisations or individuals who sought to participate in regulatory hearings sometimes appeared to be an uncomfortable one.

Nevertheless, despite these various difficulties, it was apparent from the various interviews conducted that the process of US utility regulation generally functioned reasonably well so far as representation of the consumer interest was concerned. In

1. I was also fortunate in being able to spend several days at the Langdell Law Library at Harvard University and the Dickinson Law School Library in Carlisle, Pennsylvania, during which time I obtained a considerable amount of useful research material in this area.
particular, the provision of a state funded mechanism by which the consumer perspective could be strongly pressed at regulatory hearings by lawyers with specialist experience in this area meant that rate setting decisions inevitably had to take account of the consumer interest. Frequently expert economic and accounting evidence was adduced by the state consumer bodies, and the chapter includes a detailed study of some New York initiatives in this area. Increasingly also in recent years, the need for formal rate setting hearings was obviated by the use of negotiated pre-hearing settlements involving the state consumer bodies, the utility companies and the state regulatory commissions. The mechanisms for achieving such outcomes will be described in more detail in the course of this chapter.

The chapter also deals with federal rule making with reference to the FCC regulatory process. This has recently undergone some changes of emphasis with the passing of the Telecommunications Act 1996 through Congress. A reasonable appreciation of some of the practical aspects of FCC regulation was gained by speaking with officials of that office. Much FCC material is now available on the internet and this part of the chapter makes reference to FCC material obtained from that source.

Finally the chapter seeks to draw various conclusions as to the efficacy of US economic regulation in these areas. It endeavours to show how such a structure might be applied to the processes of UK economic regulation and what modifications might be necessary to achieve this.

10.2 The Role of the State Public Service Commissions and Federal/State Jurisdiction in Regulatory Matters

In chapter 4, the evolution of the existing system of regulation by the US state public utility commissions was briefly considered. The discussion in that chapter showed how US municipal ownership of utility companies during the nineteenth century, gave way, in the early part of the present century, to regulation by state public utility commissions. New York state was a pioneer in this area. During 1905, the state of New York undertook an investigation into the provision of gas and electricity

2. See part 4.3.1 of chapter 4.
services in New York City. The investigating committee discovered that state utilities were guilty of widespread overcharging, discriminatory rate setting and provision of services which were unsafe and unreliable. ³

This investigation led to a recommendation that the state government regulate private utilities through a separate and independent administrative agency which could investigate and assess rate levels and quality of service. Counsel assisting the commission, a well known New York City lawyer, Charles Evans Hughes, campaigned for election as governor of New York State on the issue of utility regulation and was elected on this platform in 1906. Hughes’ opponent, the newspaper magnate William Randolph Hearst,⁴ had campaigned on the issue of continuing municipal ownership of utilities and was defeated.

Legislation creating the Public Service Commission of New York State was passed in 1907. This innovation was the prototype for commission regulation of utilities in the other US states, a system which eventually became universal. The state utility commissions were fundamentally concerned with preserving and promoting the public interest in the area of provision of utility services, both in terms of the consumer interest and the protection of the state economies. State commissions were concerned with ensuring that essential public utility services could meet present and projected levels of demand and that utility companies operated efficiently and provided their services at a reasonable cost.

The state commissions have perceived their role as being administrative in nature rather than judicial or quasi-judicial. Public utility hearings are presided over by an administrative law judge, operating independently of the commission itself.⁵

³ I am grateful to Ms Jane C Assaf, senior staff attorney with the State of New York Public Service Commission, Department of Public Service, for providing me with a copy of the Commission’s publication, History of the Public Service Commission, during an interview with me in Albany, New York State, on 17 January 1996. This publication provided useful material on the development of public utility regulation by commission in New York state.

⁴ Hearst was the same man who by implication was immortalised (or at least made notorious) by Orson Welles’ famous 1941 film Citizen Kane.

However, the commission does play an active role in relation to the provision of utility services and rate setting issues.\(^6\)

The future role of the state public utility commissions is presently the subject of some speculation in the United States with the imminent deregulation of certain public utilities, particularly in the electricity industry. Chapter 6 discussed the demarcation between state and federal jurisdiction over the electricity industry,\(^7\) an issue which remains unresolved, and is still quite topical, particularly given the advent of retail wheeling as described below.\(^8\) In relation to electricity, the United States is in some ways following the lead of British experience in moving to an electricity market in which industrial and commercial customers (and eventually private customers) will be able to select their electricity supplier on a competitive basis. This development is predicted to bring about strong downward effects on industry price levels.

These deregulatory initiatives were first made feasible under the US Energy Policy Act 1992, although some moves to deregulate the US electric utility industry were evident before this.\(^9\) While transmission and distribution systems are to remain

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6. See the New York State Public Service Commission publication, *supra* note 3, p 4: "With the direct assistance of its professional staff, the Commission is an active force in all aspects of utility regulation and not merely a referee. Thus, the Commission takes the initiative in setting and enforcing service standards, auditing company operations, defining the rights of utility consumers, and actively intervening on behalf of consumers who have billing or service disputes with a utility. The Commission also undertakes investigations and policymaking proceedings on its own initiative when it deems necessary."

7. See part 6.1.2 of chapter 6.

8. For a summary of current developments in this area see Glazer, "Jurisdictional Gridlock: A Pathway Out of Darkness" *Public Utilities Fortnightly*, 1 January 1996, p 29. Mr Glazer, writing from the perspective of his position as chairman of the Ohio Public Utilities Commission, noted at p 30 of his article: "The FERC has not explained why unbundling changes the nature and exercise of its jurisdiction. Moreover, the FERC has not come to grips with the full implications of its decision to grab what clearly were retail transactions. Where does the FERC's new-found jurisdiction end? And how will it be administered? Right now, the states adjudicate claims over transmission matters related to items such as the effect of electromagnetic fields and stray voltage on the milk production of dairy herds. Do I now send the citizens groups and irate farmers with cows in tow down to North Capital St. because only the FERC has jurisdiction over transmission service? And if a major industrial customer in a retail wheeling environment experiences a power surge or voltage problem, do I now send them to the FERC for resolution? I don't think the FERC really wants these cases, nor do I think that the federalization of these purely state and local issues are what Congress has in mind. Yet these are the implications of the FERC's policy."

monopolies, electricity generators are to be permitted to have unrestricted access to those systems on equal terms, which would allow generating companies to compete among themselves for customers. Under the 1992 Act, the Federal Power Act has been amended so as to permit the Federal Energy Regulatory Commission (FERC) to require electric utilities that operate transmission facilities in the wholesale market to extend those services to firms which sell or generate electricity for wholesale sales. This might conceivably include firms which lease generating plant and owners of co-generation or small power production facilities (known under the 1992 Act as Qualifying Facilities or "QFs").

The right of state governments to provide for competition at the retail level by way of direct access to power suppliers (so called "retail wheeling") has been expressly preserved under the 1992 Act. This has given rise to much contemporary debate concerning the position of utility companies which have been obligated under existing regulatory arrangements to enter into long term capital investment in utility plants. If the element of natural monopoly in the industry was to be removed by the introduction of competition in a deregulated market then such firms might foreseeably be left with redundant generating capacity (so called "stranded assets"). If the cost of old and inefficient generating plant had to be completely written off then this might cause financial ruin to such companies. (It might also give rise to litigation based on allegations that such deregulatory policies effectively amount to

10. For a general discussion of the background to these developments see article by Tomkins in the Financial Times, 1 May 1995: "A switch to the electricity shop"; LeBoeuf, Lamb, Greene & MacRae, Competition, Structural Change and Regulatory Reform in the US Electric Utility Industry (CRI Publication, International Series No. 1, April 1994), (which discusses the significance of the 1992 Act); Hyman, "The Electric Industry in Transition" Public Utilities Fortnightly, 1 September 1994, p 19.

11. For a general discussion of the concept of retail wheeling see LeBoeuf et al, supra note 10, chapter 4, pp 43-46. As the authors comment at p 46: "The future for retail wheeling orders at the state level appears to be bright, at least until retail wheeling is demonstrated to cause system reliability and/or rate inequity problems that cannot be cured through regulation. Retail wheeling's greatest appeal lies in the choice that it gives consumers, which gives it the appearance, if not the reality, of promoting competition and least-cost energy pricing. If those benefits accrue solely or primarily to large industrial customers, leaving residential customers with increased costs and no alternative suppliers, retail wheeling's appeal may diminish. Moreover, significant regulatory questions remain unanswered: the treatment of exiting and returning customers and excess general capacity, whether 'stranded' or not; and the enforceability of the franchise obligation to serve in light of retail wheeling."
deprivation of a utility company's property without adequate compensation in breach of the due process clause in the US Constitution.\(^\text{12}\)"

These concerns were reflected in the academic literature as pressure in favour of retail wheeling at the state level mounted from 1994 onwards,\(^\text{13}\) beginning with its introduction in California in April of that year. Further steps were taken towards competitive setting of electricity rates in California following a decision of the California Public Utilities Commission on 20 December 1995, in which the Commission voted to allow to power generators in California to set rates in response to market forces rather than through the process of rate setting by public hearings.\(^\text{14}\)

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12. The fixing of reasonable rates for utility companies by the state public utility commissions was held at a comparatively early stage to be a proper exercise of the police power vested in the states and not to be confiscatory in nature in terms of the US Constitution. See *New York v Woodhaven Gaslight Co* 168 NY Supp 429 (1917). However, forcing a utility company to write off the cost of all, or a substantial proportion, of its plant without compensation might well be held to exceed the supervisory jurisdiction of the commissions.

13. For more detailed discussion of the regulatory issues arising out of plans to introduce retail wheeling at the state level see Cross, "Diversification Puts Regulators on Edge" *Public Utilities Fortnightly*, 1 February 1994, p 41 (noting that retail wheeling will put considerable pressure on regulators to balance the interests of consumers against those of utility companies with stranded assets); Rudden and Hornich, "Electric Utilities in the Future: Competition is Certain, The Impact Is Not" *Public Utilities Fortnightly*, 1 May 1994, p 21 (noting an increased emphasis on retail wheeling will lead to significant structural changes in the market place which will require adaptation on the part of regulatory commissions); Cross, "Retail Wheeling - Happy Motoring for State Regulators?" *Public Utilities Fortnightly*, 15 June 1994, p 46 (noting approaches to retail wheeling taken by the Michigan and California State Public Utility Commissions, including co-ordination of the implementation of retail wheeling initiatives with utility plant investment programmes so as to reduce the effects of stranded investment); McCullough and Brown, "Electric Industry Restructuring: The Effect on Rates Nationwide" *Public Utilities Fortnightly*, 15 July 1994, p 20 (noting that the introduction of retail wheeling in California in April 1994, providing for a staged opening up of the market over the period 1996 to 2002, will give rise to significant problems in dealing with stranded assets, which will need to be addressed by regulatory commissions through rate allowances or tariff mechanisms); Hyman, "The Electric Industry in Transition", *Public Utilities Fortnightly*, 1 September 1994, p 19; Strand, "Retail Wheeling: A View from Michigan" *Public Utilities Fortnightly*, 15 September 1994, p 29; Forde, "New Game, New Rules: How can you judge credit quality of competitive electric utilities?" *Public Utilities Fortnightly*, 15 October 1994, p 22; Rudden and Rosenbloom, "Competitive Forces and Market Risks: Regulators' Views of the Future Electric Utility Industry" *Public Utilities Fortnightly*, 15 November 1994, p 22.

14. The Commission's decision of 20 December 1995 can be found on the internet at http://gopher.cpuc.ca.gov/electric_restructuring/951220_dec.html. Among other things, the final decision of the Commission, D.95-12-063 (as modified by an addendum approved on 10 January 1996, D.96-01-009) requires electric utility companies in California to design and give effect to consumer education programmes designed to acquaint consumers with the working of a competitive retail market. The decision also requires a stakeholder group, comprised of parties with an interest in the regulatory process, to be formed to assist with the implementation of the restructuring proposals. The functioning of this group is set out at pp
The Commission's report has been given legislative effect by the California state legislature through a Bill passed on 23 September 1996.\textsuperscript{15}

These initiatives are to be extended with effect from January 1998, when, under present proposals, California electricity generators will be permitted to sell electricity into a pool at a half hourly rate determined by fluctuations in supply and demand. These proposals have been controversial, not least because the California PUC has shown a willingness to allow utility companies to recover all of their stranded costs through rate surcharges.\textsuperscript{16}

Similar proposals have also been introduced in other state jurisdictions. In New York, progress has been slightly slower than in California, although in a significant decision issued in May 1996,\textsuperscript{17} and revised and amended following petitions for 8-9 of the Commission's decision. The stakeholder group is to consist of 19 members, including representatives of the utility companies (5 members) and representatives of non-utility electric service providers (4 members) with the remainder to be made up of representatives of consumers, environmental groups, low income groups, ratepayers, proponents of bilingual programmes and other state agencies. As the Commission noted at p 9 of its decision (internet version): "The above categories represent a balanced view of the electric restructuring debate. Such a balance will help ensure that no particular viewpoint will be able to control the group's efforts, that the efforts of the EREG [Electric Restructuring Education Group] will be neutral and unbiased, and that the information is disseminated to all customer groups." These proposals bear an interesting (though probably unintentional) resemblance to the stakeholder theory of regulation outlined in chapter 5 of this thesis.

\begin{enumerate}
\item See Assembly Bill 1890 (Stats. 1996, Ch 854). For a further discussion of these legislative proposals and current progress with electric industry restructuring in California see the Commission's web page entry entitled "Electric Restructuring in California", http://gopher.cpuc.ca.gov/elec.shtml.
\item See article in \textit{The Economist}, 6 January 1996, p 38: "Electricity Deregulation: A Nasty Shock", in which it was noted at p 39: "Of the state's three big utilities, Southern California Edison has $12.4 billion of stranded costs on its books, more than one and a half times its market capitalisation. Pacific Gas & Electric, the nation's largest utility, has $9.5 billion of stranded costs. A third of America's 113 investor-owned utilities are in a similar mess. Without some form of compensation, the utilities would face financial ruin. Generously, the PUC has given the power companies in California until 2005 to recover all their stranded costs. // In exchange, California's major utilities have promised to lower their rates by 25% over the next five years. But consumers' expectations may be dashed when the utilities, no longer obliged by their political masters to hand individual ratepayers a hidden subsidy, find themselves at the beck and call of their corporate customers." The 1998 proposals are discussed in more detail by the California Commission at web site page http://gopher.cpuc.ca.gov/news/970506 DIRECT_ACCESS.html.
\item \textit{Case 94 - Opinion and Order Regarding Competitive Opportunities for Electric Service} (Opinion No 96-12, NYPSC, May 20, 1996).
\end{enumerate}
rehearing in July 1996, the Commission ordered electric utilities operating in New York state to restructure their activities in a competitive framework. The decisions also rejected a claim by the utility companies that they ought to be permitted to have the benefit of rates which allowed them to recover all stranded costs in their entirety (unlike the position taken by the California Commission), and emphasised that this issue ought to be considered on a case by case basis.

The Commission's approach has recently survived a judicial review challenge in the Supreme Court of the State of New York. The Court was principally concerned with the issue of whether the Commission had jurisdiction to restructure the industry on a competitive basis and whether the Commission's rejection of the proposition that all stranded costs should be recovered infringed the constitutional rights of the utility companies. There was also an issue as to whether the Commission had followed the rule making notification procedures set out in the State Administrative Procedure Act.

On the factual issues the Court expressly deferred to the Commission's expertise. The Court noted that in recent years there had been changes in the method of delivery

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18. Case 94 - Opinion and Order Deciding Petitions for Clarification and Rehearing (Opinion No 96-17, NYPSC, July 1, 1996).

19. The Commission's decisions can be accessed through the New York Commission's internet web site home page at http://www.dps.state.ny.us. It is interesting to note that the debate on recovery of stranded assets has also arisen in the EC context, where European electricity suppliers have begun to recognise that the deregulated European market is also likely to render a considerable number of industry assets redundant. See for example article entitled "Stranded Assets in Europe" in Energy Utilities, September 1995, p 8. In the EC context the issue of utility compensation has been pursued through a process of lobbying of the European Commission by the affected industries through a specially constituted lobbying body called Eurelectric.


21. See the Court decision, ibid, at p 5 of the internet version: "The Court wishes to make crystal clear that on factual issues and decisions, unless same are obviously arbitrary and capricious, the Court must defer to the expertise of the PSC and not attempt to superimpose its own factual perceptions. Factual determinations are the province of the People, acting through their representatives, the Legislature, and the PSC insofar as authority is properly delegated thereto; only the Law is the province of the Court, limited solely to the question as to whether legal authority existed for the actions of the PSC - not the merits of those actions." Later at p 10 (internet version) of its decision the Court noted: "When the wheat is separated from the chaff, the one immutable rule of ratemaking comes down to this: is the 'end result' just and
of utility services from "bundled" to "unbundled" delivery. It took the view that the New York Public Service Law should not be read in a restrictive fashion so as to limit effective retail wheeling, and held that the proposed restructuring was within the wide discretion vested in the Commission to fix reasonable utility rates. On the issue of stranded costs, the Court took the view that the constitutional provisions as to deprivation of property did not apply to the extent of guaranteeing full recovery to utility companies of their stranded costs.

In the end result, the Court concluded that the Commission was entitled to proceed with its plans for competitive restructuring of the industry and was not constitutionally bound to allow the utility companies to recover all losses incurred as a consequence of the competitive process. On the issue of compliance with the State Administrative Procedure Act, the Court took the view that the Commission's statement on restructuring, which set out an expected policy rather than a direction to the utility companies, was a statement of general policy rather than a rule, and therefore did not require formal notification under the state APA. (However the Court affirmed that if the Commission reached the stage of directing restructuring of the industry in a particular way then appropriate notification under the state APA would be required.)

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22. "Bundled" utility services were traditionally delivered as an integrated whole with all stages of the process, such as generation, transmission, delivery and customer billing, in the case of electric utilities, being charged at a single rate, but have more recently become "unbundled", or divided into separate components to promote competition at the retail level. For a discussion of these concepts see the decision in Associated Gas Distributors v FERC 485 US 1006 (1988), in which it was held that "bundled" rates in the gas industry had an anti-competitive effect and it was therefore legitimate to recognise the validity of "unbundled" rates.

23. See the Court decision, supra note 20, p 9 of the internet version: "Just and reasonable rates do not necessarily guarantee utilities net revenues nor do they immunise utilities from the effects of competition. The due process clause has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces."

24. See the Court decision, supra note 20, p 10 of the internet version.
The New York proposals are now proceeding further to the stage of consideration of restructuring plans filed by the various utility companies operating in the state. The Commission noted at a public session held on 9 October 1996 that several companies had filed plans (prior to the New York Supreme Court decision referred to above being delivered) and the Commission has set a timetable for procedural steps leading to a formal determination by the Commission on these plans. Major issues which the Commission has directed should be addressed at the public hearing include issues of system reliability, the degree of recovery of stranded costs and the need to preserve opportunities for public interest research, cost effective energy efficiency and the protection of the environment.

In the case of Massachusetts, the State Commission issued a decision on 1 May 1996 aimed at promoting a restructured electric industry in the state along competitive lines. This decision is now the subject of a rule making exercise, together with a draft Bill which is proceeding through the state legislature.

Finally, in the fourth state jurisdiction surveyed, that of Maine, possible restructuring of the electric industry along similar lines is contemplated under a proposal by the State Commission which is presently under consideration by the state legislature. If adopted, a competitive structure for the electric supply industry would commence with effect from January 2000. In the meantime the state of Maine has been something of a pioneer in US state regulatory circles in terms of its innovative

25. These procedural steps can be found in the Commission's timetabling decision, a copy of which is available at web site http://www.dps.state.ny.us/OrdersEle/94E0952.OR-2.t.

26. The Commission's goals in this area are summarised in its decision of 16 May 1996 on competitive opportunities, a summary of which can be found at web site http://www.dps.state.ny.us/elecomp.html.

27. Details of these developments can be found at web site http://www.magnet.state.ma.us/dpu/restruct.htm.


29. The Commission's Final Report and Recommended Plan Docket Number 95-462, released December 31, 1996, can be accessed through the internet web site page of the Maine Public Utilities Commission at http://www.state.me.us/mpuc/homepage.htm. A series of open public forums is being held by the Maine Commission during the first half of 1997 to gain public feedback on these proposals. See web site page http://www.state.me.us/mpuc/onroad3.htm.
consideration of alternative forms of rate regulation, other than traditional rate of return regulation. The Commission adopted an alternative form of rate regulation in relation to the telephone industry in a decision issued in May 1995.\textsuperscript{30} This revised structure was based on the adoption of a price cap formula taking into account inflation and productivity factors, and bears more than a passing resemblance to the OFTEL pricing regime operating in the United Kingdom. It provides interesting evidence that a regime of public hearings in the utility context is not necessarily restricted to jurisdictions which set prices based on rate of return considerations.

In the electricity supply industry, similar innovations have been investigated. An Alternative Rate Plan (ARP) was adopted in January 1995 for electricity suppliers within the state.\textsuperscript{31} Again, this rate plan included a price cap component, with allowances for inflation and efficiency savings and contained an innovative formula for profit sharing between the utility company and its customers. For this purpose, profits are divided into various band widths and profit sharing can occur within those bands based on considerations of achievement of target goals of productivity and efficiency. The Commission views these proposals as a stage on the road towards attainment of full competition in the electricity supply industry longer term.\textsuperscript{32}


\textsuperscript{31} See State of Maine Public Utilities Commission, Re Central Maine Power Company - Proposed Increase in Rates - Docket No. 92-345(II), January 10, 1995. I am grateful to Mr Mitchell Tannenbaum, senior staff attorney of the Maine Public Utilities Commission, for providing me with a hard copy of the Commission decision in this matter during an interview with him at Augusta, Maine on 19 January 1996. A summary of the Commission's decision is now available on the internet at web site http://www.state.me.us/mpuc/92345sod.htm. These developments are all the more noteworthy given the fact that historically the State of Maine had pursued a restrictive power policy with stringent controls on the export of power outside the state. For an account of the policies of this period see Smith, The Power Policy of Maine (Univ of California Press, Berkeley, Calif, 1951).

\textsuperscript{32} See summary of the Commission decision, \textit{bid}, pp 3-4 of the internet version: "As a Commission, we have an obligation to mirror the effects of genuine competition to the extent consistent with our broader commitment to serve the public interest. The proposed Stipulation fulfills this obligation in at least two ways. // First, the pricing flexibility component moves towards leveling the playing field between CMP and its competitors in the retail energy market, while recognizing that the degree of competition and consumer information and expectations, have not yet reached the point where all pricing constraints can safely be removed. Second, the price cap provisions of the Stipulation, together with the virtual elimination of the fuel clause, give incentives and create risks for CMP's management much closer to those found in less regulated companies. We view this as a positive step away
The trend towards retail competition in the US electricity industry has shown that the transition from a closely regulated industry to a deregulated one involves a number of difficult issues, not the least being the need to balance the consumer interest against projected financial loss to the utility companies for the depreciation in value of their "stranded" assets. These issues are reflected in the regulatory regime, particularly in terms of a predictable decline in the significance of formal rate setting hearings in the utility context. This in turn is likely to signal, at least in the longer term, a decline in the significance of the rate setting role of the state public utility commissions. However, before such a situation can come about, a number of difficult issues, such as determining a way of providing fair compensation to utility companies that have invested on the basis of the previous regulatory regime, need to be addressed.

These considerations, of course, beg the underlying question of whether rate setting processes based on rate of return regulation provide adequate protection to utility customers in any event. There are well known arguments, which this writer does not propose to plumb in great detail here, which suggest that regulation of this kind may be counter productive, in that it is said to lead to a deliberate inflating of expenses and investment (so called "gold plating") and to discourage incentives to efficiency in capital expenditure. The alternative rate setting proposals adopted by the State of Maine and referred to above have been motivated at least in part by such deficiencies.

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While rate setting by regulatory intervention is likely to be less significant in a deregulated utility market, the US experience shows that the transition from regulation to deregulation is fraught with a number of difficulties, so that the need for regulatory controls over utility rates is not likely to disappear completely for some time to come.

10.3 Public Hearing Procedures in Regulatory Matters and the Use of Judicial Review

The requirement for public hearings in respect of rate setting matters, in terms of the statutory requirements in the US APA, has earlier been canvassed in chapter 6. This part of the chapter consists of a more detailed discussion of the mechanics of the rate setting process based on public hearings, together with some comments on the use of the remedy of judicial review in this area. The use of adjudicative procedures in this area contrasts with the more widespread reliance on rule making procedures in other fields of US economic regulation. However, because the public utility commissions perform an important role in utility regulation, and are the primary focus of consumer representation in the pricing and service area, they merit some analysis in this chapter.

The process of rate setting by public hearing in the various US state jurisdictions is not a completely uniform one, but nevertheless most states exhibit various common characteristics in relation to their hearing regimes. In general the rate setting process is initiated when a utility company within a particular state jurisdiction applies for a rate increase to the state public utility commission, which has the power to fix reasonable rates. In the normal course, the company will advertise its intention to seek a rate increase by publishing a newspaper notice. The company then files a

34. See part 6.4.2(iii) of chapter 6.

35. See, for example, the commentary in New York Jurisprudence (2d), volume 88 (Lawyers Cooperative Publishing, Rochester, NY, 1990), § 29: "The public service commission's two functions are to pass upon the reasonableness of prices to be charged for utility service and the rules and regulations governing its sale and distribution and to investigate and ascertain that utilities under its supervision are acting fairly. Broad powers are vested in the public service commission with respect to investigation into the business and affairs of public utility companies."
revised tariff schedule with the commission. This document sets out in detail the proposed new rates and charges covering the provision of services by the utility company in question. The commission will then suspend the operation of the new tariffs while the hearing regime proceeds. The case is assigned to an administrative law judge to oversee and the commission staff analyse the company's application to determine which parts of the application, if any, should be opposed in the public interest.

Hearing procedures are governed by statutory rules of procedure in each state. Generally these envisage adversarial processes which are similar to those applicable to general civil litigation in the courts. Discovery is available on application by either party and pre-hearing conferences are often convened at which the issues for the public hearing are discussed and clarified before the administrative law judge. Written statements of evidence with accompanying documentary exhibits are filed by the utility company. These may be voluminous (often extending to several thousand pages in length) and set out the basis for the utility company's view that additional revenue is required to cover projected costs for the rate year to which the new tariff relates so as to enable the utility company to earn a fair return on its investment.

The various states have prescribed suspension periods for the new tariffs while the rate setting process proceeds. There are normally three such periods. There is first an initial 30 day suspension period following the initial newspaper advertisement

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36. In New York State, for example, the relevant provisions are set out in Public Service Law, Title 16, Laws of New York, (text on the internet at web site http://www.dps.state.ny.us/pslaw.htm), which prescribes detailed provisions for rate hearings. These provisions go into some detail as to the evidence required to be adduced by the utility in respect of certain financial aspects. See for example § 61.5, which provides as follows: "Establishment of original cost and accrual depreciation. Where return is involved or claimed, the utility shall establish by competent evidence the original cost of the property used and useful in the service to which the rates, rules and regulations involved in the proceeding relate and the accrued depreciation thereon. All property not so used and useful shall be excluded (note particularly of section 61.3[d][5] of this Part). Accrued depreciation as used herein means the loss or depletion in worth or value, compared with a specified cost new, due to all causes which bring about the ultimate retirement of the property, such as wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities. Departure from newness, estimated cost of needed repairs or that part of depreciation which may be measured by inspection alone will not be accepted as satisfactory evidence of the total amount of accrued depreciation actually existing in the property."
referring to the new tariffs. The commission will then generally impose a first stage suspension period of 120 days while preliminary steps are taken such as the filing of evidence. This is typically followed by a 6 month suspension period while the rate setting process proceeds to a full public hearing if necessary. Total suspension periods of some 11 months can therefore result while the rate setting process takes its course.

The administrative law judge assigned to the rate setting case has the responsibility of setting a timetable for the public hearing, following consultation with the parties. This involves conducting pre-trial conferences and determining any interlocutory matters which may be necessary, such as disputes about the scope of discovery or evidence to be adduced at the hearing. The judge ensures that the utility company has properly published its rate request in the newspaper and deals with any questions of standing in relation to parties who intend to be represented at the public hearing.

The state public service commission has various lawyers on its staff who present the commission's case at the public hearing and prepare lay and expert evidence (such as statements by accountants and economists) for use at the hearing. Other interested groups or individuals, known as intervenors, may also participate in rate cases. Such intervenors will customarily include the state consumer protection authority, the role of which will be described in further detail below. There may also be particular interest groups, such as industry organisations, independent consumer organisations, unions and government agencies who will seek to intervene in particular rate setting cases. Intervenors will normally make themselves known to the public service commission and the administrative law judge who has been assigned to the case. Normally they will attend pre-hearing conferences and may participate in pre-hearing procedures.

The commission and individual intervenors may submit their own lay and expert evidence. Normally this evidence will seek to contradict the utility company's case in terms of forecasted costs and expenses. For example, objection may be taken to certain projected expenses of the utility company, such as overheads or borrowing
costs. Pre-hearing depositions at which the statements of evidence are taken before the formal hearing can extend over several months.\textsuperscript{37}

The public hearing itself generally follows standard adversarial procedures. The utility company begins by presenting its case and its lay and expert witnesses can be cross examined by the other parties. The state public service commission then presents its case and its witnesses can similarly face cross examination. Other intervenors can then present their cases and their witnesses may also be cross examined. The utility company and other participants are then permitted to present their case in rebuttal and further cross examination can take place. Statements of evidence taken at preliminary depositions hearings can be used at the hearing proper.

Following the completion of evidence the parties in the case then present written submissions, known as "briefs", to the administrative law judge. These summarise factual and legal aspects of the case and set out arguments in favour of that party's position. Following completion of this process the judge then writes a recommended decision, which is generally issued to the parties about three months prior to the expiry of the 11 months suspension period. This is essentially a draft decision which sets out the judge's views on the matter. Often it will contain calculations showing the financial effect of the decision in terms of increased revenue.

The parties to the case can then file supplementary briefs challenging particular aspects of the draft decision. When these have been received the judge prepares a comprehensive final decision which is then presented to the state commission for discussion. The commission reviews the record and the judge's decision and reasoning at a public session and then issues a formal decision, followed by an appropriate rate setting order. The parties affected can then file requests for a rehearing within 30 days. These may not seek to adduce new evidence but can draw

\textsuperscript{37} This is one area in which US civil procedure differs markedly from that of the UK and Commonwealth jurisdictions (with the notable exception of Canada). The systems in these latter jurisdictions limit the pre-trial involvement of witnesses to procedures such as discovery by verified list of documents and an obligation to provide sworn answers to interrogatories.
attention to alleged errors in the reasoning of the decision. The commission responds to these requests, following which there is the possibility of judicial review applications being brought. A summary of the steps involved in a typical US state rate setting process is set out in Appendix I to this chapter.

So far as judicial review in the rate setting area is concerned, the first point to note is that there are statutory restrictions on the power of the US federal courts to entertain judicial review applications relating to rate setting orders made by state agencies such as public utility commissions. In general judicial review of the decisions of state public utility commissions can therefore only proceed through the state courts and is outside the federal jurisdiction.38

Discussions with lawyers employed by the various state public utility commissions indicated that judicial review applications by utility companies, while not unknown, were less common than in the case of applications to review the decisions of federal regulatory agencies. In part, this was because the state courts tended to be staffed by judges who were often considered by litigating parties to be of lesser calibre than the judges of federal courts. It was therefore commonly perceived that complex arguments involving economic and accounting evidence might not be dealt with by the state courts in a satisfactory fashion. The state courts also tended to defer more consistently to the decisions of state public utility commissions, so that utility companies frequently took the view that seeking judicial review in state courts was not likely to be a productive course. These opinions seemed to be borne out by the

38. See *Judiciary and Judicial Procedure*, Title 28, USCS, §§1338 to 1390. § 342 of 28 USCS provides: "Rate orders of State agencies: The district courts shall not enjoin, suspend or restrain the operation of, or compliance with, any order affecting rates chargeable by a public utility and made by a State administrative agency or a rate-making body of a State political subdivision, where: (1) Jurisdiction is based solely on diversity of citizenship or repugnance of the order to the Federal Constitution; and (2) The order does not interfere with interstate commerce; and (3) The order has been made after reasonable notice and hearing; and (4) A plain, speedy and efficient remedy may be held in the courts of such State." For a discussion of the rationale for this provision, which is aimed at preserving state jurisdiction over public utility rates, see *Tennyson v Gas Service Co* 506 F 2d 1135 (1974); *Shrader v Horton* 471 F.Supp 1236 (1979), affirmed 626 F 2d 1163; *Harford Consumer Activists Association v Hausman* 381 F.Supp 1275 (1974); and the commentary in *New York Jurisprudence* (2d), *supra* note 35, § 89.
relatively few reported decisions involving state court review of decisions of state public utility commissions.39

In general, it appeared from the research undertaken that the comprehensive hearing requirements of the US rate setting process resulted in a decision which was difficult to challenge on review. This was especially the case given the provision for filing supplementary briefs based on the initial recommended decision of the administrative law judge, prior to the issuing of a final decision by the state public utility commission concerned.

10.4 The Use of Negotiated Settlements and Consensual Procedures

Research undertaken for this thesis in relation to the practical operation of US public utility regulation revealed that in the past four or five years there has been increasing emphasis on the settlement of rate cases. In each of the four US state jurisdictions in which research was undertaken a large proportion of such cases, averaging around some 70% to 80%, had been settled over this period.40 This increased emphasis on negotiated settlements arose as a response to the significant cost of public regulatory hearings, including loss of executive time and resources on the part of both the public utility commissions and the utility companies concerned, together with the perceived uncertainty attaching to the outcome of adversarial hearings.41 Even where the

39. See for example Central Maine Power Company v Maine Public Utilities Commission and Ors 395 A 2d 414 (1978, Maine SC); Rochester Telephone Corporation et al v Public Service Commission of the State of New York et al 614 NYS (2d) 454 (1994, NY Supreme Court, Appellate Division); Citizens Utility Board v Illinois Commerce Commission 655 NE (2d) 961 (1995, Illinois Court of Appeals); New York Telephone Co v Public Service Commission 98 AD 2d 535 (1984), all of which upheld the Commission's decision which was under review. See also the decision of the Supreme Court of the State of New York on the validity of the New York Commission's plans to restructure the state electricity supply industry, supra note 20.


41. For a useful survey of the shortcomings of the traditional rate making process as it was applied in New York State, see Bronner, The Use of Negotiated Settlements in Public Utility
outcome might have been thought to be reasonably predictable in any particular case, there was still a period of uncertainty for up to twelve months while the public hearing process progressed through its various stages. All of these factors have tended to provide impetus for the use of negotiated settlements in the various state jurisdictions.  

Settlement initiatives are somewhat easier to undertake in the public hearing context than in the context of licensing procedures (such as those applicable under the former FCC regime) where competing tenderers vie with each other for the award of the particular licence or franchise, so that there is little scope for a negotiated outcome. Frequently the settlement process involves extensive input from public intervenors, such as the state consumer representation bodies in each US state jurisdiction.

Most of the state jurisdictions surveyed had adopted formal settlement guidelines which were designed to expedite the settlement process in a manner which was likely to result in settlements which would be acceptable to the state public utility commission concerned. In the case of New York State, for example, procedural guidelines were first issued in 1983 and some 50 settlements were approved during the period 1983 - 1990. The New York State Public Service Commission instituted
revised settlement guidelines in June 1990, a copy of which is included as Appendix II to this chapter. Similar guidelines are in force in other state jurisdictions.

The guidelines themselves place emphasis on the need to involve all interested parties in the structuring of a settlement and the New York Commission requires actual notice of settlement meetings to be given to all interested parties who have indicated a wish to participate. Where a draft settlement has been reached by the major participants, this must be filed with the Commission with full supporting data of the same detail and quality as would be required for a public hearing.

Enforcement of the settlement procedure, including the obligation to notify interested parties, is the responsibility of the Administrative Law Judge, who sets a timetable for the settlement process and monitors compliance with the programme which has been set. Settlements may be reached in respect of the whole case or isolated issues within it. Parties putting forward a proposed settlement are required to prepare a detailed record for submission to the Commission. The settlement may be opposed by third parties before the Commission by offering evidence and cross examination.

43. See New York Department of Public Service, Procedural Guidelines for Settlements (1992) (Case 90-M-0255, June 14, 1990). (I am grateful to Ms Jane Assaf, staff counsel with that Department, for providing me with copy of this document and accompanying explanation of the functioning of the settlement process in the course of my interview with her in Albany, New York State, on 17 January 1996.) The rationale for the guidelines is set out on page 1 of the document as being as follows: "The comments and the settlement experience to date show that the existing procedure can, with some modification, continue to reduce time and expense and to develop innovative regulatory approaches, while protecting the rights of the parties."

44. In California, for example, see Article 13.5 - Stipulations and Settlements of the Rules of Practice and Procedure of the California Commission, text on the internet at web site http://gopher.cpuc.ca.gov/rules/fulru.htm. Under the California Rules, parties promoting a settlement must convene at least one conference with all interested parties, though such a conference can be a private one among the parties and the representatives themselves. If a settlement is reached then this can be submitted to the Commission for approval. Parties not supporting a settlement can contest the settlement as part of the approval process and the Commission has wide powers to allow renegotiation of the settlement or to suggest alternative terms of settlement to the parties. Settlement negotiations are confidential to the parties and are not subject to discovery or admissible in evidence at any evidentiary hearing.
of witnesses for the parties propounding the settlement. There is statutory authority for this regime.45

Given the tight timetable for resolution of public hearings, it is of course necessary to ensure that input into the settlement process does not jeopardise the timetable for resolution of the public hearing, given the possibility that a final settlement may not be reached, or a proposed settlement may not be approved by the Commission. The Administrative Law Judge is therefore required to ensure that both procedures are carried on in tandem so that the timetable for resolution of the public hearing itself is not prejudiced. Much of the documentation required by the settlement procedures themselves (such as the development of a record and the filing of adequate factual testimony) is also required for the public hearing procedure so there is considerable scope for dovetailing the requirements of both processes.

The New York State settlement guidelines set out criteria to be applied in determining whether a proposed settlement is in the public interest.46 In the event that settlement is not reached then the positions adopted by the parties during the settlement negotiations do not prejudice their ability to develop new and different

45. See New York Public Service Law, supra note 36, Appendix, "Rules of Procedure of the Public Service Commission of the State of New York", §3.9: "3.9 Settlement procedures. (a) Notification required for settlement discussions in pending proceedings involving large utilities. As soon as it appears, based upon exploratory discussion with another party or potential party, that settlement of an issue or issues in a pending proceeding is possible, the utility shall file, with the secretary, a notice of impending negotiation. The notice shall contain the following: (i) a general description of the issues that may be settled; (ii) a list of the persons or parties to the negotiations; and (iii) a certification by a duly authorized representative of the utility that all appropriate persons and parties have been or will be notified of the pendency of negotiations in a manner so as to permit a reasonable time for preparation. // (2) The Administrative Law Judge assigned to the case shall review the notice to ensure all persons who reasonably should have been notified of the pendency of the negotiations have been afforded a reasonable opportunity to participate. The Administrative Law Judge may take any action necessary to protect the rights of persons participating or desiring to participate in the negotiations or who reasonably should have been notified of the pendency of negotiations. The Administrative Law Judge shall report the results of the procedural review to the commissions."

46. Procedural Guidelines for Settlements (1992), supra note 43: "1. In determining whether or not a proposed settlement is in the public interest, the following standards shall obtain: (a) A desirable settlement should strive for a balance among (1) protection of the ratepayers, (2) fairness to investors, and (3) the long term viability of the utility; should be consistent with sound environmental, social and economic policies of the Agency and the State; and should produce results that were within the range of reasonable results that would likely have arisen from a commission decision in a litigated proceeding. // (b) In judging a settlement, the Commission shall give weight to the fact that a settlement reflects the agreement by normal adversarial parties."
positions at the public hearing itself. Finally the settlement discussions themselves are confidential and in addition the Administrative Law Judge has power to exclude disruptive parties from the negotiations.

The increased emphasis on negotiated settlements in jurisdictions such as New York State has had a beneficial influence on the regulatory process in respect of public utility rate making. The insistence of the state commissions, through the use of published settlement guidelines, in fully involving third parties in the settlement process has served to ensure that such parties are not disadvantaged by accommodations reached between the major participants in rate making hearings. Negotiated settlements have also served to alter the "mind set" of the participants in favour of adversarial processes, as Bronner has noted in his study of the New York experience.

Discussions with the staff of the New York Public Service Commission indicated that the New York Commission was now taking a more proactive role in encouraging negotiated settlements in rate cases. In recent cases concerning retail wheeling heard during the period 1993 - 1994 the Commission in fact directed the various parties to act in a collaborative fashion so as to develop a commonality of approach on the issue of competitive opportunities in power generation.

In New York State the Commissioners have adopted the practice of following their previous decisions as a matter of general principle, so lending increased certainty to

47. Ibid section 2, pp 8-9.

48. See Bronner, supra note 41, p 13: "This case study of public utility regulation in New York State during the past twenty years illustrates that it is possible that too much litigation can occur. While entities appear to be able to change their organization design quite easily to participate in the intense litigation that is associated with regulatory issues, a series of unexpected negative effects occurred as the litigation was conducted. A litigation mentality clearly developed which made the participants focus on legal strategies rather than on series of important public policy issues. This problem was mitigated to some extent during the 1980s by the use of negotiated settlements instead of litigation to resolve regulatory disputes. While the negotiated settlement process can still produce some aspects of litigation, it does appear to have its benefits in that it allows all of the parties to directly negotiate with their adversaries rather than having a state of continuous legal warfare. The parties are forced to solve their differences through a cooperative effort where they must reflect on their actions."

49. Information supplied by Ms Jane Assaf and Mr Steven Blow, staff counsel with the New York Department of Public Service, supra note 40.
the rate making process and enabling the parties to negotiated settlements to predict more accurately what the outcome of a full public hearing might be in any particular case. Where the Commissioners have decided to depart from previous decisions their reasons for doing so are invariably explained in their decision. A major rate making case in New York previously involved two to three attorneys for each of the major parties, together with up to thirty lay and expert witnesses. The latter might commonly include accountants, economists, engineers, environmental consultants and survey researchers. All of this expense and complexity could be substantially reduced by a negotiated settlement reached at a comparatively early stage of the rate making procedure.

Discussions with the consumer representation bodies in the state jurisdictions indicated that these organisations played a valuable role in ensuring that negotiated settlements were not unduly favourable to the utility companies. The New York Consumer Protection Board (NYSCPB) expressed the view that negotiated settlements reached during the early 1990s had sometimes been too generous to the utility companies. In part this had arisen because the Commission staff had allegedly not adopted a sufficiently aggressive or proactive stance in relation to the companies' pricing demands.

The NYSCPB had opposed many negotiated settlements over this period and had succeeded in obtaining lower pricing levels as a result of this intervention. The Board itself was entitled to file a petition with the Commission to reduce existing rates and had in fact resorted to such a course from time to time.

The New York experience was substantially replicated in the states of Maine and Massachusetts. In the case of Maine, which was a smaller state jurisdiction, the settlement rate was somewhat lower than in New York State with approximately half of all rate making cases having been settled by negotiation during the period 1991-1995. The Maine Commission had considerable discretion under the relevant statutory framework and was not greatly constrained by judicial review in the state.

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courts, with few such applications being successful in recent years. In the case of Massachusetts, negotiated settlements were also encouraged by the State commission. These had been particularly prominent in relation to water utility companies. The settlement process was encouraged by the fact that Commission staff were aware from their experience of the likely attitude to be taken by the Commissioners to settlement proposals, which allowed the staff to form an accurate view as to which settlement proposals would be likely to receive approval.

Negotiated settlements had not been commonly resorted to in Massachusetts prior to 1989. The Massachusetts Commission recognised that these might have some disadvantages, as well as advantages. For example the State Consumer Protection Body sometimes insisted on other conditions being incorporated in a negotiated settlement which were not directly relevant to the dispute in question, but which served to advance the interests of consumers in other, related areas. The reservation was expressed that a utility company might effectively be held to ransom in such circumstances if it desired to achieve a negotiated settlement and this could only be done by accepting the burden of such extraneous conditions. However, despite these possible difficulties, the Massachusetts Commission considered that the settlement process worked well overall and certainly expedited the regulatory process in this area.

The Commonwealth of Massachusetts Office of the Attorney General was responsible for representing the consumer interest in regulatory hearings. Discussions with that office revealed that over the period 1990 - 1996 some 90% of rate cases had tended to settle, a much higher proportion than during the 1980s. The settlement procedures varied among the utility companies. It was generally recognised that the claims made by the utility companies were pitched at a level exceeding the settlement figure which a company would accept. The Attorney General's Office took the view that it ought not to be seen as being anxious to initiate

51. Interviews with Mr Mitchell Tannenbaum, Senior Staff Attorney; Faith Huntington, Economic Policy Adviser; Chuck Cole, Staff Attorney, Maine Public Utilities Commission, Augusta, Maine, 19 January 1996.

52. Interview with James Connelly, General Counsel, The Commonwealth of Massachusetts, Department of Public Utilities, Boston, Massachusetts, 22 January 1996.
settlement discussions. In general it adopted the approach of preparing cases on the basis that they might well run to trial, so that the companies' financial records were fully analysed and appropriate expert evidence was commissioned.\textsuperscript{53}

The Office tended to take a comparatively strong line with both the utility companies and the State Public Service Commission and indeed some degree of friction between the Commission and the Attorney General's Office was evident from my discussions. Mediation processes had occasionally been adopted with varying degrees of success. The major constraint in this area was the ability to find suitable mediators sufficiently well qualified and experienced in the utilities area to be acceptable to the parties.\textsuperscript{54}

Looked at overall, the advantage of formalised settlement procedures in the US public utilities context was both philosophical and practical in nature. At the philosophical level, the availability of formalised structures of this kind served to encourage participants in the regulatory process to consider a negotiated resolution of the dispute instead of regarding an adversarial determination as being inevitable. From a practical perspective, the procedures helped ensure that interested third parties were not excluded from the negotiations leading up to settlement and were kept fully informed of progress with any such initiatives.

The fact that the processes of negotiated settlement and preparation for a full public hearing proceeded simultaneously might have involved the risk of duplication of effort. However, much of the work required for both processes was similar in nature and extent, so that the amount of additional effort required was not disproportionate to the benefits to be obtained from a resolution of regulatory disputes by negotiated settlement. In response to those who argue that such a process is unduly cumbersome for transplantation to other jurisdictions such as Britain, it should be borne in mind that many of the US state jurisdictions are comparatively small both in terms of

\textsuperscript{53} Interview with Mr George B Dean, Assistant Attorney General, Chief of the Regulated Industries Division, Office of the Attorney General, The Commonwealth of Massachusetts, Boston, Massachusetts, 22 January 1996. The Attorney General’s Office has an internet web site at http://www.magnet.state.ma.us/ag.

\textsuperscript{54} For a discussion of some of these issues at both the state and federal levels, see Perritt, "Administrative Alternative Dispute Resolution: The Development of Negotiated Rulemaking and Other Processes" (1987) 14 Pepperdine LR 863.
population and resources, yet nevertheless manage to staff and implement the required commission infrastructure quite successfully.\textsuperscript{55}

10.5 The Representation of the Consumer Interest in US Regulatory Hearings

The discussion in the preceding part of this chapter showed that negotiated settlement procedures were designed so as to take account of the consumer interest and to ensure that this was reflected in the outcome of the process. It is instructive to consider in further detail in this part of the chapter how the US system of consumer protection in regulatory matters functions in practice. Again the discussion in this part of the chapter draws on the interviews conducted with US state consumer protection bodies during January 1996.

In order to appreciate the role of the state consumer protection bodies in this area, some understanding needs to be gained of the role of intervenors and their ability to participate in regulatory hearings before the State Public Utility Commissions. This is an area which has given rise to a considerable amount of academic scholarship in the United States, particularly during the 1970s and early 1980s.\textsuperscript{56} Much of the underlying concern in this area arose from the recognition that representatives of the consumer interest would be disadvantaged if they lacked the resources and expertise to present a consumer perspective before state regulatory hearings.

The perception arose that state utility commissions did not possess the resources to represent consumer interests adequately and also lacked a mechanism to distinguish

\textsuperscript{55} The example of Maine, which is one of the smaller US state jurisdictions, showed that the regulatory system could be implemented by a comparatively small team of attorneys and other staff experts not exceeding 30 in number.

between different categories of customer, such as large commercial and industrial users as opposed to small residential users. The situation has been improved in more recent years by the establishment of separate consumer representation bodies by the State Attorneys General. Such bodies are separate from the State Public Utility Commissions and have a specialised staff of attorneys with particular expertise in representing the consumer interest at state regulatory hearings. Most US state jurisdictions now have separate bodies, frequently operating as a division of the State Attorney General's Office, which represent the consumer interest in state regulatory hearings.

Another factor which clearly influences the degree to which the consumer interest is promoted by state regulatory procedures is the outlook of the commissioners themselves. The mechanism for appointing commissioners varies among the states. In some US state jurisdictions, commissioners are elected, although the predominant mode of appointment is by the state governor. Some studies have suggested that elected commissioners take a more proactive stance in relation to rate setting matters, resulting in lower consumer prices, although this conclusion has been strenuously doubted by others.

57. Although such structures have a long pedigree, with the prototype statute being adopted by the State of Maryland in 1922, by 1976 only some ten US states had such a structure in place. For the history of such bodies see Leighton, "Consumer Protection Agency Proposals: The Origin of the Species" (1973) 25 Admin LR 269; Wortman, State Provisions for Consumer Representation Before Public Utility Commissions (Common Cause, Washington DC, 1975); Comment, "The Attorney General as Consumer Advocate" (1973) 121 U Pa LR 1170.

58. The competing points of view can be found in articles such as Harris and Navarro, "Does Electing Public Utility Commissions Bring Lower Electric Rates?" Public Utilities Fortnightly, September 1, 1983, p 23; Hagerman and Ratchford, "Some Determinants of Allowed Rates of Return from Equity to Electric Utilities" (1978) 9 Bell J Econ 46; Costello, "Election of Regulators: The Case of Public Utility Commissioners" (1984) 2 Yale J Regn 83. Costello takes a sceptical view of the proposition, arguing at pp 104-105 of his article as follows: "In summary, it probably makes little difference to the average ratepayer whether a PUC is elected or appointed. If anything, elected commissions may cause electricity rates to rise in the long run because they tend to create at least the appearance of an unfavourable regulatory climate. Without other reasons for changing the method of selecting regulators, this evidence argues for maintaining the status quo. Any change would entail substantial implementation costs - including the cost of establishing election procedures, the cost of running the elections, and the cost of election campaigns - without producing any apparent benefits." For a more detailed theoretical study in this area see Gormley, The Politics of Public Utility Regulation (Univ Pittsburgh Press, Pittsburgh, 1983).
The effectiveness of consumer representation in regulatory hearings will depend in part on how readily consumers are enabled to participate as intervenors in regulatory hearings. In all of the state jurisdictions surveyed, the state PUCs invariably took a relatively liberal view of the eligibility of intervenors to take part in regulatory hearings. In general this was a matter within the discretion of the commissions in terms of the applicable statutory provisions and the relevant case law. In the case of the New York statute, the grounds for granting standing to intervenors are set out in some detail. Similar rules apply in other state jurisdictions. So far as

59. In Massachusetts, as in the case of other states, the State Administrative Procedure Act confers a broad discretion on the commission. See General Laws of Massachusetts c 30A, § 10: "Unless otherwise provided by any law, agencies may... (4) allow any person showing that he may be substantially and specifically affected by the proceeding to intervene as a party in the whole or any portion of the proceeding, and allow any other interested person to participate by presentation of argument orally or in writing, or for any other limited purpose, as the agency may order." The Supreme Court of Massachusetts has upheld the wide discretion which this provision vests in the commission. See for example Newton v Department of Public Utilities 339 Mass 535 at 543 (1959); Save the Bay Inc v Department of Public Utilities 366 Mass 667 (1975); Boston Edison Company v Department of Public Utilities 375 Mass 1 at 44-46 (1978); Attorney General v Department of Public Utilities 390 Mass 208 at 216-217 (1983); Robinson v Department of Public Utilities 835 F 2d 19 (1st Cir 1987). In relation to electricity consumers the Public Utility Regulatory Policies Act 1978 16 USC § 2631(a) provides as follows: "...Any electric consumer...may intervene and participate as a matter of right in any rate making proceeding or other appropriate regulatory proceeding relating to rates or rate design which is conducted by a State regulatory authority...or by a nonregulated electric utility."

60. See Public Service Law, supra note 36, § 4.3: "(3)(c)(1). Any person may ask the presiding officer for permission to intervene. Permission will be granted if the intervention is likely to contribute to the development of a complete record or is otherwise fair and in the public interest. // (2) Permission to intervene after a hearing has commenced may be sought and granted at any time, unless the presiding officer determines that granting such permission would be unfairly prejudicial to other parties. A party intervening after the start of the hearing shall be bound by the record as developed to that point and by such conditions of intervention as the presiding officer may impose." For relevant case law in this area see Campo Corp v Feinberg 106 NE 2d 70 (1952); New York Telephone Co v Public Service Commission 397 NYS 2d 223 (1977). As New York Jurisprudence, supra note 35, puts it at pp 68-59: "The general scheme of the Public Service Law contemplates that only public utilities are entitled to hearings, and the intervention of a customer is a matter of discretion with the commission. However, with regard to hearings before the commission to increase utility rates, the controlling standard of procedural due process means that a party whose interests may be affected is entitled to procedures tailored, in light of the decision to be made, to the capacities and circumstances of those who are to be heard to insure that they are given a meaningful opportunity to present their case. Thus, a statute requiring that the commission hold a hearing where a major change in utility rates has been proposed, prior to making an order, contemplates a full public hearing, mandates more than merely a review by the commission and its staff of the utility's written filing and summary disposal thereof, and requires that all interested parties be permitted to call and cross-examine witnesses and rebut adverse claims."

61. In California, for example, Rule 53 of the Rules of Practice and Procedure, supra note 44, provides as follows: "53. (Rule 53) Intervention. In a complaint procedure petitions to
compensation is concerned, there are also statutory limitations on the powers of commissions to order costs in favour of intervenors.62

The possibility of having a range of intervenors involved in regulatory hearings could lead to difficulty where the regulatory hearing involves sensitive evidence in areas such as commercial pricing and similar matters. For this reason, the commissioners have statutory power to identify trade secrets and make appropriate confidentiality orders.63 This power is apparently quite frequently invoked in practice by utility companies. Finally, the commissioners are not bound by the

intervene and become a party thereto shall be in writing, shall set forth the grounds of the proposed intervention, the position and interest of the petitioner in the proceeding, and whether petitioner's position is in support of or opposition to the relief sought. Such a petition shall be served and filed by petitioner at least five days before the proceeding is called for hearing, except for good cause shown. If petitioner seeks a broadening of the issues and shows that they would not thereby be unduly broadened, the petition shall be served and filed by petitioner at least ten days, and the parties may serve and file replies at least five days, before the matter is called for hearing. // Leave will not be granted except on averments which are reasonably pertinent to the issues already presented, but do not unduly broaden them. If leave is granted, the petitioner thereby becomes an intervener and a party to the proceeding to the degree indicated by the order allowing intervention, or by the presiding officer at the hearing."

62. See for example Public Utilities Act, Maine RSA, Title 35-A, § 1310: "1310. Funding of intervenors by the commission: Notwithstanding sections 104, 111 and 112, the commission may not order compensation of intervenors by any utility except as authorized by this section. Compensation of intervenors may be ordered only to the extent that compensation is specifically required by the United States Public Utilities Regulatory Policies Act of 1978, United States Code, Title 16, Section 2601, et seq." In California, the question of intervenors' costs is dealt with in some detail at Article 18.8 of the California Rules, supra note 44, which allows for compensation to be awarded pursuant to the provisions of the California Public Utilities Code, Division 1, Part 1, Chapter 9, Article 5, Sections 1801ff.

63. See for example New York Commission Rules of Procedure, supra note 45, § 6-1.4(c): (c) Safeguarding trade secrets in administrative hearings. The presiding officer shall take appropriate measures to preserve the confidentiality of trade secret information. Measures to be considered include, but are not necessarily limited to: (1) limited access to the material; (2) deleting sensitive material that is not relevant to issues in the hearing; (3) aggregating or summarizing data in a manner that preserves the confidentiality of trade secret information; and (4) restricting attendance during portions of a hearing at which trade secret proof is to be introduced." The validity of such confidentiality orders was upheld by the US Supreme Court in Reisman v Caplin 375 US 440 (1959) and in FCC v Schreiber 381 US 279 at 296 (1965): "If and when information was demanded which if disclosed might in fact injure MCA competitively, there would be amply opportunity to seek judicial protection if the request were denied." For a case in which the court reversed a refusal by the New York Public Service Commission to grant confidential status to certain evidence in a regulatory proceeding see New York Telephone Company v Public Service Commission of the State of New York 436 NE 2d 1281 (1982, NY Court of Appeals).
technical rules of evidence in regulatory hearings, which tends to assist intervenors who are not legally qualified and are appearing on their own behalf.

Discussions with the US state consumer protection bodies revealed a diversity of experience with intervenors. In New York, the NYSCPB was the predominant body engaged in protecting consumer rights in relation to utility proceedings. A similar, private body, the Citizens Utility Board, also participated in state regulatory hearings. There was some degree of friction evident between such bodies and the NYSCPB, with the latter believing that a fragmented approach to consumer issues served to weaken consumer advocacy before state regulatory commissions. The NYSCPB also believed that the CUB was inclined to adopt somewhat outlandish positions on some consumer issues and often endeavoured to take the credit for work done by the state body. The relationship between the NYSCPB and such private consumer organisations was clearly an uneasy one.

In Massachusetts, the Attorney General's Office had had varied experience with intervenors. Generally the Office did not encourage individual intervenors to participate in regulatory hearings as they tended to prolong regulatory hearings, often to no good purpose. There were in fact several well known individuals in the state of Massachusetts who were notorious for appearing on their own behalf at PUC regulatory hearings and pursuing dubious arguments. However, there were also several organised consumer groups who contributed usefully to regulatory hearings and there was some co-operation with such groups.

So far as the financial effect of consumer intervention was concerned, the Massachusetts office had estimated that its activities saved a minimum figure of 5% each year on customer utility rates. The Office had considerable experience in analysing information supplied by utility companies in their rate making applications and in identifying gaps and inconsistencies in such information. It had access to the

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64. See for example New York Public Service Law, supra note 36, § 20(1). (Such liberalising provisions do not meet with universal approval. For an article arguing that Administrative Law Judges ought to reject hearsay evidence see Rose, "Hearsay in Administrative Agency Adjudications" (1992) 6 Admin LJ 459.)

65. Information supplied by Joel Blau of the NYSCPB during interview, supra note 50.

66. Interview with George B Dean, supra note 53.
services of a financial analysis and an economist for this purpose and the state
government budgeted for sufficient costs to cover staff expenses, expert evidence and
other overheads involved in representing the consumer interest at regulatory hearings.

In general the system of state funded consumer representation bodies appeared to
function quite well in practice. Such bodies accumulated considerable expertise in
representing the consumer interest at regulatory hearings and in the negotiation of
settlements and frequently intervened in regulatory hearings for this purpose. The
provision of state funded bodies of this kind served to overcome the usual difficulties
of lack of resources and expertise and resulted in appreciable cost savings for the
customers of utility companies.

10.6 Practical Aspects of Consumer Representation by State Bodies - A Case
Study of the New York Experience

The following section consists of a case study of the operations of the New York
Consumer Protection Board based on empirical research undertaken in Albany, New
York State on 17 January 1996. This part of the chapter will deal with the role of
the Board and practical aspects of the Board’s operations, including the way in which
the Board obtains instructions and a consensus of opinion from utility customers.

The NYSCPB is legally entitled to represent utility consumers in rate proceedings
before the New York Public Service Commission. The Board itself may become an
intervenor in such proceedings and frequently represents residential consumers and
small business interests in New York State. In recent years the Board has achieved
significant savings for utility customers by participating in a number of rate setting
proceedings.

67. During this visit I spoke with Joel Blau, Director Utility Intervention; Ann Kutter, Legislative
Liaison Officer; Anne F Curtin, Utility Intervenor Attorney and Richard W Bossert, Chief of
Regulatory Systems Analysis, of the NYSCPB. I am grateful to all of these persons for
providing me with useful background on the Board’s activities, together with a variety of
Board publications and other relevant material. The Board has an internet web site at
http://www.consumer.state.ny.us which contains much useful information on its activities.

68. Some notable successes achieved by the Board included a moratorium on electric rate
increases by the Long Island Lighting Company in 1995, the rejection of a multi year rate
The Board operates a Consumer Complaint Unit which deals with numerous complaints by utility customers, as well as customers who have purchased goods and services generally. In addition, the Board operates a Consumer Education Unit which makes presentations to various consumer and citizens groups and attends public utility commission meetings on proposed rate settlements. During the years 1993 and 1994 the Board intervened in some 59 commission proceedings involving gas, electric and telephone utilities. These interventions covered a wide range of topics, including applications for rate increases, hearings on alternative rate making methods, innovations in the telecommunications industry including unbundling, diversification and new telephone services and competitive restructuring of the electric and gas industries.

The Board itself has been a strong advocate of the introduction of retail competition in the electric and gas industries in New York state. However the Board has also been prepared to recognise that the utility companies should be permitted to recover a reasonable proportion of their stranded costs on the introduction of competition, although it has vigorously scrutinised the costs of utility companies in relation to this aspect. While the Board represents different classes of consumers, including

increase plan proposed by Niagara Mohawk Power Company for the period 1995 to 1999 and a US$300m decrease in budgeted revenue sought by New York Telephone Co during 1994. In addition the NYSCPB has negotiated rate settlements in the interests of consumers, including agreements to freeze base gas rates charged by Rochester Gas and Electric Corporation from September 1995 to September 1998 and base electric rates charged by Consolidated Edison from April 1995 to March 1998. The Board has also played a part in bringing about the modification or rejection of a number of unsatisfactory utility rate settlements.

69. During 1993 this unit processed 15,626 complaints and inquiries, with 12,961 being processed during 1994. The complainants included not only utility customers but also consumers of commercial products, financial services and purchases of merchandise. See New York State Consumer Protection Board, Annual Report 1993 & 1994 (NYSCPB, Albany, New York, 1994).


71. The Board has created an internet web site dealing with proposals for the restructuring of the state's electric industry - see http://www.consumer.state.ny.us/cbpwhite.htm. The Board notes at p 3 of its paper: "Stranded costs are a significant percentage of costs, especially for utilities like Niagara Mohawk, NYSEG, RG&E and LILCO. Utility rates should be reduced by sharing stranded costs between all those who would benefit from restructuring the electric utility industry: utility shareholders, IPPs and customers."
residential customers and small businesses, it has generally had little involvement with larger industrial and commercial customers. The latter have tended to engage their own lawyers on rate setting matters.

As the larger customers have often tended to assert that they bear an unfair burden of utility charges, this has in turn served to minimise possible areas of conflict between the different classes of utility customer. This is particularly the case given that larger customers have tended to have preferential discount arrangements in place and were also in a position to apply greater negotiating leverage to utility service providers.\textsuperscript{72}

In terms of representation at consumer hearings, staff attorneys at the NYSCPB have regularly represented the consumer interest at public service commission hearings and have considerable experience in this work, probably much more so than would be the case if attorneys from private law firms were engaged for this purpose. The Board also has staff accountants and economists who can provide expert testimony and external consultants are sometimes engaged for particularly complex cases. The Board also undertakes amicus briefs defending PUC decisions against applications for rehearing lodged by the utility companies.\textsuperscript{73}

So far as judicial review applications were concerned, the Board's experience was that decisions of the Commission were difficult for the utility companies to overturn in the state courts given the openness of the hearing process and the specialist expertise of the Administrative Law Judges and of the commissioners themselves. The New York State Courts tended to defer to decisions of the Commission and it was rare for such decisions to be overturned on judicial review.

An area which was of particular interest was the procedure adopted by the Board for liaising with customers and consumer groups so that the Board could assert with some confidence at Commission hearings that the stance it was taking did

\textsuperscript{72} Information supplied at interview by Joel Blau, Director Utility Intervention, NYSCPB, Albany, New York, on 17 January 1996.

\textsuperscript{73} Information supplied at interview by Anne F Curtin, Utility Intervenor Attorney, NYSCPB, Albany, New York, on 17 January 1996.
legitimately represent the consumer interest.\textsuperscript{74} During the mid 1980s the Board began the practice of creating focus groups of local area representatives which would hold regular public meetings, often at local public libraries, for the purpose of obtaining a consensus of opinion within a local area about utility pricing and service issues. As utility issues became more complex and technical during the 1990s, particularly with the advent of proposals for introducing competitive opportunities into the electric and gas industries in New York state, the Board considered that more formal researching techniques should be introduced to ensure consumer awareness and to obtain a representative cross section of consumer opinion.

The proposed restructuring and deregulation of the state's electricity industry provided the impetus for a Public Involvement Program to gather data on issues of interest to electricity consumers. The Board arranged for electricity consumer focus groups to meet during June and July 1995. The proceedings of these groups were taped and the tapes were made available for public listening. At the same time consumer survey questionnaires were developed by the Board and were distributed to a sample of 700 residential electric customers at three separate locations in New York state during July and August 1995. Other initiatives included the use of regional discussion groups, media briefings and the depositing of material at the 900 branch libraries in the New York State Library System.\textsuperscript{75}

The survey results obtained from the survey of residential and small business electricity consumers were instructive. Generally the consumers surveyed wanted customers generally to benefit from increased competition arising from the proposed restructuring of the electric industry. They expressed a preference for being able to choose their electricity supplier but at the same time small business and residential customers were conscious of the need to be protected against utility rate increases

\textsuperscript{74} In researching this aspect I was fortunate in being able to have in-depth discussions over several hours with Richard W Bossert, Chief of Regulatory Systems Analysis of the NYSCPB, on 17 January 1996 concerning the procedures adopted in this area.

\textsuperscript{75} These initiatives are described in a paper issued by the Implementation Committee responsible for the Program, \textit{Competitive Opportunities Public Involvement Committee Work Plan} (NYSCPB, Albany, New York, August 1995). I am grateful to Mr Richard W Bossert of the NYSCPB for providing me with a copy of this document.
which might result from larger commercial and industrial customers moving their business to another utility company.

Consumers were less sympathetic to issues of stranded cost and were generally opposed to allowing utility companies to recover losses resulting from uneconomic investments and long term power supply contracts. In general consumers placed a high value on safe, reliable and affordable electricity services with a significant minority expressing a preference for being able to choose combinations of service and price to meet their particular individual requirements.

The survey format itself is included in Appendix III to this chapter. The survey results themselves were collated and were the subject of extensive analysis by the NYSCPB. The results themselves were broken down as between residential customers and small businesses, different areas of New York state, gender, levels of education, age and household income and as between the utility companies themselves. The detailed survey results enabled the Board to form an accurate view (with a level of statistical error of about 10%) on the various matters covered by the survey.76

Over the next few months the Board undertook further statistical analysis of the results of the surveys and also the results of meetings of consumer discussion groups concerning the restructuring proposals.77 This exercise revealed a high degree of correlation between the findings obtained from analysis of group discussions as compared with the results obtained from the survey process. Variations between the two results were thought to have arisen from the inclusion of some large industrial customers in some of the discussion groups, the narrower focus of the survey questions and statistical sampling variations which were an inevitable part of the survey process. Despite these variations the Board was satisfied, to an acceptable

76. See Case 94-E-0952 - Competitive Opportunities Proceeding, Residential and Small Business Electricity Consumer Survey Results (Richard W Bossert, NYSCPB, Albany, New York, October 20, 1995). I am grateful to Mr Richard W Bossert for providing me with a copy of this publication in the course of our interview on 17 January 1996.

77. The discussion group findings are summarised in the Board's publication, Competitive Opportunities Case 94-E-0952, Report on the Regional Discussion Groups held with Residential Commercial and Industrial Electricity Customers (NYSCPB, Albany, New York, October 1995). Again I am grateful to Mr Bossert for providing me with a copy of this publication.
level of statistical error, that these processes had provided an accurate view of consumer opinion on the issue of electric industry restructuring.

The above discussion shows that it is possible to obtain a representative view of consumer opinion on utility issues if sufficient resources, both financial and intellectual, are devoted to the task. The NYSCPB believed that its initiatives as outlined above were the most comprehensive of their kind at that time in the United States and the Board was confident that its survey results would be instrumental in representing the consumer interest in an effective fashion in relation to industry restructuring issues.

10.7 A Study of Aspects of FCC Rule Making

This part of the chapter consists of a study of certain aspects of FCC rule making in the light of the substantial legislative changes contained in the Telecommunications Act 1996, which took effect on 8 February 1996. Again the material in this part of the chapter is based in part on discussions with FCC executives in Washington DC during January 1996.78

The FCC was originally established under the Communications Act 1934 and is responsible for regulating interstate and international communications by radio, television, wire, satellite and cable. The Commission itself consists of five commissioners who are appointed for five year terms by the President with the confirmation of the Senate. No more than three commissioners may be members of the same political party and no commissioner is permitted to have a financial interest in any matters which are subject to the Commission's activities. The Commission itself consists of six operating bureaus, being Mass Media, Cable Services, Common Carrier, Compliance and Information, Wireless Telecommunications and

78. These included Ms Aileen Pisciotta, Chief of Planning and Negotiations; Don Gips, Chief of the Office of Planning and Policy and Mr Stephen A Bailey, Assistant Chief Counsel, FCC. I am grateful to Mr Robert Bruce, partner in the London office of the US law firm Debevoise & Plimpton and former Chief General Counsel for the FCC for arranging introductions for me to these people. I am also grateful to Mr Bailey of the Commission, in particular, for supplying me with copies of various FCC publications, including the FCC’s information pack.
International. There are eleven staff divisions of the Commission, including the Office of the General Counsel, which is responsible for providing legal advice and assistance to the Commission.79

Jurisdiction in respect of US communications matters is divided among the state Public Utility Commissions and the FCC, which are respectively responsible for areas of state and federal jurisdiction in the communications sector.80 Prior to the divestiture of the US telecommunications industry in the mid 1980s, the FCC exercised a range of regulatory responsibilities in relation to telecommunications issues.81 The trend towards deregulation in the second half of the 1980s in both telephony and cable television services, resulted in a change in emphasis in FCC regulation away from detailed financial and programming regulation of the television and broadcasting industries in favour of the formulation of broader policy rules. This was accompanied by a move away from cost based, rate of return regulation towards permitting greater flexibility in terms of market entry and encouragement of a competitive industry structure.82

Under the Telecommunications Act 1996, remaining regulatory barriers in the industry have been largely eliminated and competition over nearly every industry sector has been encouraged. In the area of telephone services the Act removes regulatory restrictions which previously prevented the "Baby Bells", the local Bell Operating Companies, from offering long distance telephone services and engaging in previously prohibited activities, including manufacturing and electronic publishing. However concerns as to possible dominance in relation to long distance


82. For a discussion of these developments see Crandall, "Relaxing the Regulatory Stranglehold on Communications" (1992) 15 Regulation 26. The developments in the cable television industry over this period are described in Allard, "The 1992 Cable Act: Just the Beginning" (1993) 15 Hastings Comm & Ent LJ 305.
services dictated that such moves be preceded by competition in the market for local telephone services.

In general the 1996 Act attempts to achieve its objectives in two general ways. First it seeks to invalidate state or local restrictions prohibiting a telephone company from providing a local telephone service. Secondly the Act makes entry into the long distance telephone market conditional on the adoption of measures which are intended to ensure that competing providers can obtain non discriminatory access and interconnection to the local network.  

This wide range of legislative changes will in turn necessitate extensive revisions to the FCC regulatory regime. The FCC itself has estimated that implementation of the 1996 Act will require more than 80 different rule making and other Commission proceedings covering some 38 different areas. The strain which this will undoubtedly place on the FCC's resources is ameliorated to some extent by provisions in the legislation which authorise a reduction in the intensity of FCC regulation in certain areas.  

The FCC itself is considering a number of proposals to expedite its rule making processes and other regulatory procedures. These include prescribing abbreviated timetables for rule making proceedings, procedures for the filing of briefs and arguments in summarised form, greater use of interpretative rules which are not subject to the APA notice and comment requirements and a more stringent attitude towards frivolous positions taken in regulatory proceedings. While these proposals may be expedient from the point of view of the FCC’s responsibilities to implement


84. For example the Act allows the FCC to withdraw from regulating the telecommunications industry where such regulation is no longer necessary to protect the public interest. In addition, certain FCC functions, such as certification, testing and field inspection of some items of radio and computer equipment can now be privatised.
the new legislation, they have been the subject of some controversy, given that some of them tend to be inconsistent with the existing APA notification and participation requirements. These developments perhaps provide a good illustration of the fact that the participation requirements in the APA may well come under increasing pressure in the US regulatory environment as under-resourced agencies such as the FCC struggle to cope with their expanded rule making obligations under new legislation such as the Telecommunications Act 1996.

From the perspective of FCC rule making, the empirical research undertaken indicated that FCC staff perceived that companies involved in the communications industry were increasingly relying on the litigation process and on the remedy of judicial review as a means of attempting to reverse unfavourable regulatory decisions, or indeed to frustrate and delay the adoption of regulatory policies which they perceived as being unfavourable to their interests.

This trend towards the use of the litigation process seemed to be more perceptible in the case of new entrants to the industry, who were frequently led by aggressive and determined management who viewed the litigation process as another weapon in the corporate arsenal. This has led in turn to greater internal scrutiny by the Office of the General Counsel of the FCC to try to minimise areas of vulnerability to judicial review applications. It was considered by the General Counsel's Office that the majority of judicial review challenges arose from a failure by the agency to follow its own internal rules and procedures and to take regulatory actions which were demonstrably consistent with statute and precedent, so allowing judicial review applications to succeed on the grounds of irrationality or arbitrary and capricious action.

Accordingly, much contemporary action by the Office of the General Counsel was preventive in nature, in that it sought to ensure that the agency's actions were internally consistent and were also taken in compliance with the applicable rules and procedures. It was thought that the wide ranging changes introduced by the 1996 legislation would themselves give rise to a number of legal challenges, particularly...
where the FCC had made determinations as to the adequacy of access and interconnection arrangements entered into by incumbent telecommunications operators.86

It might be thought to be somewhat paradoxical that at a time when US state courts are demonstrating an increasingly differential attitude towards regulatory determinations by the state Public Utility Commissions, the FCC, a federal agency operating in the context of a largely deregulated telecommunications industry, should be subject to the threat of increased litigation by way of judicial review of its decisions. The US experience, as has been seen to be the case with the largely unregulated telecommunications sector in New Zealand, seems likely to demonstrate that deregulatory initiatives in themselves need not necessarily result in a decreased use of litigation by the parties affected.

Indeed, where regulatory decisions impact on controversial areas such as non-discriminatory access and interconnection, resort to litigation is likely to become more rather than less pronounced. It will be interesting to see whether this is borne out by the US experience as the FCC embarks on a number of rule making initiatives for the purpose of implementing the new legislation.

10.1 Conclusions

The foregoing case studies of US economic regulation have illustrated the following points:

a) At the US state level, the state courts have tended to defer to decisions of the state regulatory bodies such as the public utility commissions more consistently than have the US federal courts. This fact in itself has tended to act as a disincentive for utility companies seeking to invoke the remedy of judicial review in respect of state regulatory decisions.

86. I am grateful to Mr Stephen A Bailey for discussing these matters with me in some detail in the course of my interview with him on 11 January 1996 at the FCC's offices in Washington DC. For a discussion of the problem of deviations from an agency's own rules see Editorial Note, "Violations by Agencies of Their Own Regulations" (1974) 87 Harv LR 629; Service v Dulls 354 US 363 (1957).
b) Moves at the state level towards competitive restructuring of the electricity industry have given rise to a changing emphasis in the role of the state public utility commissions away from detailed involvement in the rate setting process. Regulatory initiatives have tended to focus on the adoption of alternative rate setting methods in the transitional period preceding the adoption of full competition. The state commissions have had to grapple with a number of new issues, such as providing fair compensation in respect of stranded costs and ensuring that consumers are sufficiently well informed about the implications and functioning of a competitive electricity market.

c) The regime of public hearings has undergone some modification in recent years with increased emphasis being placed on achieving negotiated settlements on a structured and relatively formal basis, often with reference to published settlement guidelines involving supervision by the Administrative Law Judges. This has tended to reduce the adversarial element in rate setting proceedings at the state level.

d) The representation of the consumer interest in relation to utility pricing and service issues has tended to be the responsibility of the individual state consumer protection bodies. This process has ensured that consumers can be adequately represented by specialist attorneys through a state funded body. The public utility commissions have assisted the state consumer protection bodies in this role by mechanisms designed to achieve full participation and involvement as intervenors in regulatory hearings. This mechanism has assisted in overcoming difficulties which would normally be faced by utility consumers, such as lack of funding and specialist expertise in regulatory issues.

e) Other third parties seeking to intervene in regulatory hearings are entitled to do so providing they can demonstrate a sufficient interest in the proceeding to be granted standing as separate intervenors. Generally the state commissions have tended to take a liberal view of individual standing requirements in this area.
f) The case study of the New York State Consumer Protection Board's involvement in explaining electricity industry restructuring changes to state consumers has illustrated that, with the application of some imagination and commitment, it is possible to gain a good appreciation of consumer attitudes towards such issues. This in turn has entitled representative bodies such as the NYSCPB to be able to assert with some legitimacy that the stance they are adopting on such issues does accurately reflect consumer opinion, as revealed by both survey evidence and personal contact through discussion groups and interviews.

g) The case study of FCC rule making under the Telecommunications Act 1996 shows that moves towards a deregulated environment in telecommunications may not necessarily lead to decreased reliance on the litigation process. As the New Zealand experience had earlier shown, competitors in the telecommunications area, particularly aggressive new entrants, may well tend to utilise litigation as a way of improving their strategic market position.

h) The increasing pressure faced by US federal agencies such as the FCC also illustrates that the transition to a deregulated environment in areas such as telecommunications can well lead to the agencies seeking to abbreviate, or even circumvent, existing constraints, such as the notice and comment procedures in the US APA. This in turn illustrates that the continued maintenance of adequate consultation and participation procedures is not a matter to be taken for granted, even in the context of US regulation where such requirements are prescribed by federal statute.

Finally the case study of judicial review in the FCC context illustrates that, at a practical level, many judicial review applications tend to result from internal systems failures within regulatory agencies themselves, such as a failure to follow prescribed internal procedures and precedents set by previous agency decisions. Reliance on these grounds means that the court does not need to become embroiled with difficult issues of deference to agency decision making where the decision itself suffers from such fundamental intrinsic
defects. Attention to such matters, in conjunction with staff attorneys, can serve to reduce the incidence of successful judicial review applications.
APPENDIX I

OVERVIEW OF THE US RATE SETTING PROCESS

Time (Months)

0

Application Filed

Information Meeting(s)

Pre-hearing Conference

"Discovery" on Application (Requests by Parties for Information)

3

Public Statement Hearings(s)

Evidentiary Hearings
A. Presentation of applicant's direct case
B. Cross-examination of applicant's direct case
C. Presentation of PUC's and other parties' direct cases
D. Cross-examination of PUC's and other parties' direct cases
E. Presentation of rebuttal cases
F. Cross-examination of rebuttal cases

7

Initial Briefs to the Administrative Law Judge

Reply Briefs to the Administrative Law Judge

9

Recommended Decision of the Administrative Law Judge

Initial Briefs on Exceptions

Reply Briefs on Exceptions

11

Commission Decision

Petitions for Rehearing

Petitions for Judicial Review
APPENDIX II - COPY OF TEXT OF NEW YORK STATE SETTLEMENT GUIDELINES

Case 90-M-0255

PROCEDURAL GUIDELINES FOR SETTLEMENTS (1992)

In 1983, after a number of settlements had been negotiated and submitted for approval, we issued procedural settlement guidelines. In the next seven years, over 50 settlements were approved, some with modification to meet Commission concerns. Some were rejected. On June 14, 1990, we instituted Case 90-M-0255 to review the existing settlement guidelines.

The comments and the settlement experience to date show that the existing procedure can, with some modification, continue to reduce time and expense and to develop innovative regulatory approaches, while protecting the rights of the parties.

The modifications are necessary for the following reasons:

1. to ensure that all interested persons have the right to participate in negotiations;
2. to provide an opportunity for the Commission to identify concerns that should be considered in negotiations;
3. to formalise the requirement of confidentiality concerning the substance of negotiations; and
4. to standardise the process to be followed in the event a proposed settlement is rejected in whole or in part.

Parties should continue to pursue negotiated settlements where it appears to be in the public interest, but no party is obligated to settle a case or issue.

The settlement process can work effectively only if all parties negotiate in good faith. Parties, for example, should not seek concessions on an issue as to which they are reasonably certain that they will be unable to join in agreement unless they have so informed the other parties.

The rights of interested parties to participate fully in shaping a settlement agreement must be protected, especially when early settlement of issues among the major parties is possible. Each party need not attend or participate in all negotiating sessions, but actual notice to all parties of such meetings is a prerequisite for approval by the Commission of a settlement agreement and should be protected by regulation.
Finally, none of the changes in these guidelines affect the need for a settlement to be approved by the Commission before it has decisional consequence.

A. Initial Proposals for Settlement. In any proceeding, active parties may reach agreement among themselves on a mutually acceptable resolution of some or all of the contested issues, and submit their proposed resolution for approval by the Commission.

1. In the case of proposals which could affect materially a utility's rates or charges, the proposals shall be supported by documentation of the quality and detail required for major rate case filings. This supporting data is required even if the filing is, in the first instance, a proposal for a rate settlement but not in the form of a traditional rate case filing. In all rate proceedings, the supporting documentation required shall include the relevant information discussed in Part 61 of the Commission's Rules of Procedure, 16 NYCRR.

2. In all other types of proceedings, the supporting documentation shall be of comparable quality.

B. Notification Procedures. In order to protect the rights of interested persons to participate fully in shaping a settlement agreement, compliance with the notification procedures described in 16 NYCRR Section 3.9 (a)-(c) is mandated. It is absolutely necessary that all parties be apprised of conferences or meetings scheduled for the specific purpose of negotiating or settling issues whether in a formal case or in anticipation or avoidance of a formal case.

1. We do not intend to include in this category those discussions that our staff routinely has with company personnel during field audits and examinations, which sometimes lead to informal resolutions of disputed issues.

2. Exploratory discussions between parties, for the purpose of determining whether there is a potential for settlement of a case or issue, need not be held on notice.

3. Notice is not required for caucuses among parties with common interests for the purpose of developing a joint negotiating position; however, if a utility is involved in a caucus with any non-utility party, all parties must be notified of the meeting and allowed to attend, unless all parties consent otherwise.

C. Responsibilities of the Presiding Officer. The Administrative Law Judge will preside over party compliance with applicable rules and guidelines as well as over the scheduling of the proceeding. The Judge will protect the rights of the public and is vested with the broad authority to assure the concerns of the Commission are addressed and to interpret the guidelines in light of the facts and circumstances of specific cases.
1. The Administrative Law Judge will establish filing dates. A reasonable time will be given so that parties entering negotiations for the first time can develop a position.

2. The Administrative Law Judge may require the parties to submit periodic reports of the progress of negotiations and of the issues which are being negotiated by the parties.

3. Upon notice to the Commission by the Administrative Law Judge of the pendency of negotiations and compliance with 16 NYCRR Section 3.9, we may notify the parties of any specific concerns the Commission wishes to have considered in the proceeding or in the negotiation.

D. Scope of Settlements. Settlements may be of entire cases or selected issues, and they may be styled as unitary agreements, presented to the Commission for approval or disapproval only in their entirety and not on a piecemeal basis.

E. Responsibility of the Parties to Develop the Record. It is necessary to have available for our review as complete a record as feasible, setting forth the positions of each major party, including the staff of the Department of Public Service. The burden of proving that a proposed settlement is in the public interest rests on the parties proposing the settlement. The Administrative Law Judge should require proponents of a proposed settlement to place into the record the details of the agreement, and a statement or testimony in support, which should contain its underlying rationale and how the settlement of issues compares both to its litigating position and what it regards as the likely outcome of litigation.

1. To ensure that the Commission has input as to the sufficiency of the record, the Administrative Law Judge will provide the Commission with a copy of any proposed settlement together with a description of its terms. The purpose of this procedure will be to provide guidance to the Administrative Law Judge and the parties concerning the information we regard necessary to the evidentiary record for our review of the settlement.

2. Parties not participating in the settlement must be given the opportunity to participate fully in our proceedings. This includes the opportunity to oppose the settlement by offering evidence in opposition to the proposed settlement and the opportunity to cross-examine proponents of the settlement. For the purpose of opposing the settlement, any party may also develop fully the issues and positions it wishes to advocate, by cross-examination and by introduction of affirmative testimony.

3. In situations where settlements are reached after or near the close of the record in formally filed cases, the Administrative Law Judge must take requisite action to ensure that all parties have a fair and reasonable opportunity to develop issues and advocate positions. The procedural steps necessary to protect this right will vary depending on
the stage of the proceeding at which a settlement is reached; the Administrative Law Judge will review the settlement to determine whether additional procedural steps are necessary. Normally, such additional steps will entail the filing of briefs, but, in the rare instance where additional factual testimony is required, the Administrative Law Judge could, among other things, require additional hearings and may request the extension of the suspension period, if applicable, as a condition precedent to consideration of the settlement.

F. Standards for Review. At any hearings conducted after submission of a settlement by some or all parties, the scope of the proceeding shall be limited to the issue of whether or not the proposed settlement is in the public interest.

1. In determining whether or not a proposed settlement is in the public interest, the following standards shall obtain:

   (a) A desirable settlement should strive for a balance among (1) protection of the ratepayers, (2) fairness to investors, and (3) the long term viability of the utility; should be consistent with sound environmental, social, and economic policies of the Agency and the State; and should produce results that were within the range of reasonable results that would likely have arisen from a Commission decision in a litigated proceeding.

   (b) In judging a settlement, the Commission shall give weight to the fact that a settlement reflects the agreement by normally adversarial parties.

2. Since settlements are generally arrived at through negotiation involving compromise, it is likely that the true litigating positions of the settling parties will not have been fully tested in these hearings. Therefore, if we are persuaded that a settlement should be rejected or modified, the proceeding generally will be remanded to allow the parties to re-negotiate and/or litigate the issues which we found required modification. Where remand is not available, the settling parties will generally be given an opportunity to comment on whether our intended resolution alters their positions on the settlement.

G. Conduct of the Parties. The success of the settlement process hinges on the conduct of the parties during the negotiations. In addition to the expectations described in the Preamble to these Guidelines, the Administrative Law Judge is authorised to exclude from negotiations any party whose behaviour will demonstrably hamper or be disruptive to negotiations. Furthermore, since settlement discussions must be conducted in strict confidence, we find that a regulation is necessary which will require all participants in negotiating sessions to maintain in strict confidence all discussions, concessions and offers to settle. (16 NYCRR Section 3.9 (d)).
APPENDIX III - CONSUMER SURVEY ON ELECTRICITY RESTRUCTURING UNDERTAKEN BY THE NEW YORK STATE CONSUMER PROTECTION BOARD DURING JULY AND AUGUST 1995

Part 1

Recent federal and state rulings have begun to deregulate electric companies. One possible result of this deregulation may be that customers will be able to choose a supplier of electricity.

Listed below are some possible rights and expectations of electric consumers under deregulation or restructuring of the electric utility industry. As you read each one, indicate how important each one would be to you. Use a scale of "0" to "10" where "0" is "lowest importance or value" and "10" is "highest importance or value" to you.

Please go through the whole list twice and feel free to cross out and change your ratings before finishing. The same rating can be used more than once and all ratings between and including 0 and 10 are acceptable.

YOUR RIGHTS AND EXPECTATIONS AS AN ELECTRIC CUSTOMER UNDER A RESTRUCTURING OF ELECTRICITY SUPPLY

0 1 2 3 4 5 6 7 8 9 10

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A true and honest description of the features and limitations of the electric service you choose.</td>
</tr>
<tr>
<td></td>
<td>Safety of operations of electric service provider.</td>
</tr>
<tr>
<td></td>
<td>Reliability of service (i.e. uninterrupted supply) that you require.</td>
</tr>
<tr>
<td></td>
<td>Consistency of service (i.e. the lack of power surges or variations in quality) that you require.</td>
</tr>
<tr>
<td></td>
<td>Error-free meter reading and accurate bills that are written in plain language.</td>
</tr>
<tr>
<td></td>
<td>Courteous, friendly, timely and non-patronizing answers to questions.</td>
</tr>
<tr>
<td></td>
<td>Convenient and timely resolution of problems or disputes.</td>
</tr>
<tr>
<td></td>
<td>Quick restoration of service in an emergency.</td>
</tr>
<tr>
<td></td>
<td>A supplier that helps to obtain products and services that use electricity more efficiently.</td>
</tr>
<tr>
<td></td>
<td>A supplier whose activities and facilities are least harmful to the environment.</td>
</tr>
<tr>
<td></td>
<td>Lower or more affordable rates for large commercial/industrial customers.</td>
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<td></td>
<td>Lower or more affordable rates for small business customers.</td>
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<td>Lower or more affordable rates for residential customers.</td>
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<td>Lower or more affordable rates for low-income customers.</td>
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<td></td>
<td>Lower or more affordable rates for customers on fixed income (e.g. pension).</td>
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</tbody>
</table>
Part 2

Listed below are situations or events that could occur if the electric utility industry is deregulated or restructured. As you read each one, indicate how important each one would be to you. Use a scale from "0" to "10," where "0" is "least desired or favored" and "10" is "most desired or favored."

Please go through the whole list twice and feel free to cross out and change your ratings before finishing. The same rating can be used more than once and all ratings between and including 0 and 10 are acceptable.

| SITUATIONS YOU WOULD LIKE OR NOT LIKE TO SEE HAPPEN UNDER A RESTRUCTURING OF ELECTRICITY SUPPLY |
|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|-----------------------------------------------|
| 1    | 2    | 3    | 4    | 5    | 6    | 7    | 8    | 9    | 10   | 1    | 2    | 3    | 4    | 5    | 6    | 7    | 8    | 9    | 10   |
| Least Desired or Least Favored               | Most Desired or Most Favored                  |
| Rating                                       |

- Residential and small commercial customers share with large commercial and industrial customers in the potential savings (in rates) from electric utility industry restructuring.
- Electric rates include the costs of programs supporting the use of energy-efficient products and services.
- Small business and residential customers are protected from utility rate increases that might otherwise result when large commercial/industrial customers leave their utility.
- Environmental concerns, such as compliance with the Clean Air Act, are satisfied.
- Your electric company recovers all expenditures it made in the past (e.g., for power plants and/or power supply contracts) even if the price of electricity including those expenditures is not competitive.
- Electric utility common stockholders are protected against financial losses if the utility has difficulty competing in a restructured environment.
- Restrictions are placed on purchasing electricity from sources that are more harmful to the environment, even if such power is less expensive.
- Supplier choice is made available to all customers simultaneously rather than only large customers initially.
- Benefits of competition extend to both large and small customers rather than to only large customers.
- Restructuring of the industry raises rates for smaller customers while reducing rates for larger customers.
- All retail suppliers are required to serve (or contribute to a pool that would serve) rural and low-income customers who would otherwise not be served at competitive prices.
- All customers (rather than a select few) can choose their supplier.
Part 3

Reliability of electrical service is the assurance of an uninterrupted supply of electricity. Some large customers pay lower rates because they are willing to have their electric service shut off by the utility when the power is needed elsewhere. In return for this, these customers pay lower rates. Under a restructured electric industry, you might be offered the same option. You might also be given the option of selecting greater reliability at a higher price.

Relative to the current levels of electricity prices and reliability of service, would you like to be able to choose:

More reliability at a higher price.   ____Yes     ____No

Less reliability at a lower price.   ____Yes     ____No

Today's reliability at today's price.   ____Yes     ____No
11. REPRESENTING THE CONSUMER INTEREST IN ECONOMIC REGULATION

11.1 Introduction

The discussion in the preceding chapters of this thesis has highlighted the central position of consumers as one of the more significant interest groups in the process of economic regulation. Indeed, the case studies examined in chapter 10 showed that in the context of US economic regulation, much of the thrust of the regulatory regime in relation to public utilities has been directed to recognising and facilitating the representation of the public interest. In the United States, protection of the interests of consumers has been achieved through formalised and structured participation methods and the provision of specialised and adequately funded state consumer protection bodies. At the level of policy, the views of consumers have been recognised by the consultation and participation requirements embodied in the Federal and State Administrative Procedure Acts.

In the context of economic regulation in Britain, the approach taken to recognising and promoting the consumer interest has been somewhat different. In the area of public utilities, including rail transport, the consumer interest has generally been represented by consultative bodies which have been given statutory recognition under the legislation governing these particular sectors of the economy. These bodies have been established with a view to providing a structure for the canvassing of consumer opinion and the conveying of such opinion to the responsible regulatory body. In other areas of economic regulation, such as civil aviation and broadcasting, the legislature has sought to accommodate the consumer interest by a licensing regime accompanied by opportunities for public participation and comment.

It was not without good reason that Adam Smith wrote that consumption was the sole end of all production.\(^1\) Like other economists after him, he realised that the consumer was the cause, not the effect, of economic production. The present age is one in which consumers are sometimes perceived as cash cows to be milked by

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companies and their shareholders, rather than as the reason for those companies' own existence. It is therefore perhaps unsurprising that some have lost sight of the central position of consumers in the economic process. This flows on into issues of regulatory design in the economic area. Processes which ought to be designed to encourage and facilitate consumer input as a matter of central importance often seem to treat this feature as an incidental benefit to be attained if all other things are equal.

From a philosophical perspective, the legitimacy of recognising obligations to consumers is supported by scholars of both a right wing and left wing persuasion. Such recognition is based either on the concept that individual rights of consumers should be paramount over the interests of companies and shareholders, or alternatively, that the state should ensure that the consumer interest prevails over these competing interests.\(^2\)

In a deregulatory era, increasing emphasis on competition has also been held out as beneficial to the consumer interest. However, as the discussion in the preceding chapters has shown, increased competition has not necessarily always worked to the advantage of consumers. Indeed, some ostensibly competitive industries have become virtual battlegrounds between competing operators striving to preserve or attain dominant market power, with standards of customer service suffering as a result. The UK deregulated local bus transport industry has provided an illustration of this phenomenon. As the discussion in chapters 8 and 9 showed, such a situation is closely related to the comparative lack of strength and effectiveness of present UK competition law, especially in comparison with EC law in this area and the body of US anti-trust law.

Part 11.2 of this chapter will examine how the UK system of economic regulation functions in practice so far as representation of the consumer interest is concerned. This part of the chapter will survey some areas of strength and also some discernible areas of weakness. The former include the fact that the existing UK system is relatively informal in nature and, at least on the surface, is designed to encourage

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regional input and the possibility of lobbying of a regulatory body in favour of recognising the interests of consumers. In practice, it is arguable that the shortcomings of the system somewhat outweigh these advantages. Areas of weakness include a lack of structural independence from the regulators themselves and the fact that the regulatory bodies are not bound to take such input into account in the process of regulatory decision making. The UK system does not ensure that the consumer interest is formally recognised in regulatory decisions, particularly in areas such as pricing and standards of service, unlike the US position where the state public utility commissions are obliged to take account of the positions adopted by consumer interest intervenors at public hearings and negotiated settlements.

It is difficult to quantify the extent to which these areas of weakness have been reflected in higher prices and less satisfactory levels of service for UK consumers than might otherwise have been achievable. Nevertheless, there is considerable empirical and anecdotal evidence to suggest that both pricing and service levels have fallen below what might have been expected to be attainable under an improved regulatory system. The discussion of the water and rail industries in preceding chapters has particularly served to illustrate that this is the case.3

Experience in Commonwealth jurisdictions has shown that, even in largely deregulated economies, levels of pricing and service remain an ongoing area of concern. Part 11.3 of this chapter illustrates this proposition by an examination of the Australian and New Zealand experience in certain areas of economic regulation.

Part 11.4 of this chapter discusses alternative approaches which might be adopted to facilitate meaningful participation by consumers in regulatory decisions. This part of the chapter begins by discussing the general problem of funding and access to justice and how these factors militate against efforts by consumers to use the court system as a means of input into regulatory decisions. The possibility of bringing actions for private enforcement, perhaps based on tort of breach of statutory duty, is then examined. Some of the existing legal difficulties confronting such an approach are discussed.

3. See the discussion of the rail industry in part 4.3.4 of chapter 4 and part 7.6.1 of chapter 7 and of the water industry in part 7.4.5 of chapter 7.
Some problem areas are then addressed, such as difficulties with standing and the costs of intervention in public law and regulatory proceedings. Recent developments in this area in the United States, Britain and Commonwealth jurisdictions will be examined, including some consideration of the treatment of costs for and against intervenors.

This leads into a discussion, in part 11.5 of the chapter, of the features of an improved approach to consumer representation. Such an approach should seek to achieve the objectives set out in the regulatory benchmarks discussed in chapter 1. It is suggested in the discussion that this result might be attained through the use of participatory procedures, perhaps adopting some elements of the US model, together with the use of consensual procedures, such as arbitration and Alternative Dispute Resolution (ADR) techniques. The strengths and weaknesses of such procedures will be discussed.

Part 11.5 of the chapter then goes on to look at the type of approach which might be more effective in this area, drawing on aspects of Australian and New Zealand regulatory practice, with particular reference to emerging developments in the telecommunications industry in these two jurisdictions. Finally the chapter summarises these arguments and considerations and offers some conclusions as to a preferred approach in this area.

11.2 The Consumer Interest in UK Economic Regulation

11.2.1 How the UK System Functions in Practice

(i) The Position under Nationalisation

Under the system of nationalised industries which existed in the United Kingdom up to the mid-1980s, responsibility for relations with the public as consumers largely rested on the industries themselves. These obligations were discharged with varying
degrees of success and the performance of the nationalised industries in this area was the subject of periodic criticism.4

In his study of the nationalised industries, Professor Prosser drew attention to the various shortcomings in the performance of the Consumer Councils and Consumer Consultative Committees under nationalisation. He identified part of the problem as arising from the ambivalent mandate of these bodies,5 which had the dual role of arbiters between industries and consumers as well as advocates of the consumer interest. Prosser compared the functioning of the Consumer Councils with the more formal hearing procedures existing in the United States in the area of public utility regulation, noting the procedural advantages which the latter regime provided.6

On the issue of accountability, Prosser noted that there was little existing by way of an independent mechanism for judging the performance of the nationalised industries

4. An example of this can be found in the Second Report from the Select Committee on Nationalised Industries Session 1970-71: Relations with the Public (HC 514, 14 July 1971, HMSO, London), at para 93: "No industrial organisation is perfect and the consumer has every right to expect some safeguard against oppressive use of its position by a nationalised industry. The scope for such behaviour will of course be greater where it enjoys an element of monopoly. Where it is a question of the industry's general financial policy or involving matters which are highly technical, the sponsoring Department is in the best position to safeguard the consumer. The Department, however, does not always appear to the consumer as his champion. This is essentially the role of the consultative bodies. While their activities have been limited, they have nevertheless done enough such work of value. Your Committee believe that they could do more, particularly in the examination of the forward planning of the industries. For this purpose they might well need the resources to be able to call on the assistance of qualified advisers. Discharging this function would bring them more to the attention of the public and would thus enhance their usefulness."

5. See Prosser, Nationalised Industries and Public Control (Clarendon Press, Oxford, 1986), chapter 8, pp 151-152: "It will soon become clear that there is considerable variation in the role and practice of different consumer councils and that they have tended to be designed ad hoc, without considering general principles. Indeed, ambiguity lies deep in their role. In particular, there is unresolved conflict, both in self-perception and institutional arrangements, between the consumer councils as impartial brokers standing between the industries and aggrieved consumers, and as active advocates of consumer interests, and indeed as part of the wider campaigning consumer movement." For a general critique of the performance of the nationalised industries in relation to levels of consumer service see Ashworth, The State in Business 1945 to the mid-1980s (Macmillan, Basingstoke, 1991), chapter 6; Ernst, Whose Utility? The Social Impact of Public Utility Privatization and Regulation in Britain (OUP, Buckingham and Philadelphia, 1994) at p 155: "In the area of consumer rights, and to a lesser extent, service quality, the privatised utility industries began from what could be described as a relatively unambitious base. During their 40 years or so under public ownership, the water, electricity and gas industries had often been perceived as complacent, and even dismissive, in their approach to customer care (although interestingly, consumer surveys generally indicated a quite high level of satisfaction with service performance)."

6. Prosser, ibid, pp 174-175.
despite periodic attempts at government level to institute such arrangements.\textsuperscript{7} Codes of practice had been developed in relation to some industries, such as gas and electricity (in relation to payment of bills and disconnections) and for the operations of the Post Office, British Telecom and British Rail.\textsuperscript{8} While these codes met with some limited success in practice, their legal status remained uncertain and there were difficulties with enforcement from time to time. In general, the Consumer Councils suffered from a lack of resources and of adequate legislative powers.\textsuperscript{9}

(ii) The Position following Privatisation

With the advent of privatisation some of these structures survived, albeit with some modifications contained in the particular legislative framework governing the operations of individual industries. This in turn has raised the general issue of whether the consumer interest should be represented by the existing industry regulators (either in their own right or through some hybrid mechanism such as consumer advisory committees), or by an independent system whereby autonomous consumer representation bodies provide input into the regulatory process. In general terms, the former model has tended to represent the approach adopted in Britain, whereas the latter model has tended to represent the US approach, at least in terms of state public utility regulation, as was outlined in chapter 10.

In the context of UK economic regulation, the approach adopted in relation to consumer representation has varied with the particular industry. In areas of

\textsuperscript{7} For a description of these initiatives see Prosser, \textit{ibid}, pp 176-180.

\textsuperscript{8} For a description of these codes see Prosser, \textit{ibid}, pp 183-186.

\textsuperscript{9} See Prosser, \textit{ibid}, p 193: "We saw in chapter 8 that formal follow-up procedures are very limited... Certain indications have emerged that government in the mid-1980s has seen the need for a more systematic approach in principle, as appears from 'Strategy for Reform'... This may indeed fit in with its perception of the industries as monopolies for which substitutes for market forces must be provided. However, the rhetoric has been accompanied by virtually no practical action: to be effective the consumer councils need more resources and improved statutory powers, especially to get information, and these have not materialised. Instead, the stress has moved to privatisation, which has not only led to the loss of some of the areas previously covered by the councils, but to the central rhetorical theme that privatisation means that consumers are protected through competition and so mechanisms such as consumer councils are not needed."
franchising, such as television broadcasting and civil aviation, the consumer interest has tended to be represented in an indirect fashion through consultation procedures sponsored by the industry regulatory body, such as the ITC and the CAA, as part of the process of awarding licences or franchises. The nature of this process has been examined in chapter 9.

In the case of the privatised utilities and rail transport, the industry regulators and the relevant Secretaries of State have been given a statutory duty under the relevant industry legislation to protect the interests of consumers in each particular industry. The practical expression of this obligation has resulted in varying structures in this area.

To begin with telecommunications, the Director-General of Telecommunications has established various regional consumer representation bodies. These are of an advisory nature and are both regionally based and related to customer groupings. Some of the regional bodies have a shared complaints handling function which they carry on in conjunction with OFTEL. These functions are exercised by the advisory committees in Scotland, Wales and Northern Ireland, whereas OFTEL is responsible for consumer complaints in England.

As at June 1996, six such advisory committees were in existence. These comprised regional committees for England, Scotland, Wales and Northern Ireland, together with committees representing disabled and elderly people and small and medium sized businesses. In addition OFTEL was advised on price control and other consumer issues by a consumer panel, as well as by experts on economics, finance and fair trading. OFTEL also deals with a significant number of consumer

10. See for example the Telecommunications Act 1984, s 3(2)(a); Gas Act 1986, s 4(2)(1); Electricity Act 1989, s 3(3)(a); Water Industry Act 1991, s 2(3); Railways Act 1993, s 4(1)(a)-(b). As noted above in the text, the precise method of implementing this legislative duty has varied from industry to industry.

11. See Pricing of Telecommunications Services from 1997: OFTEL’s Proposals for Price Control and Fair Trading (OFTEL, London, June 1996), paras 1.18-1.21. The work of these advisory committees is supported by OFTEL in areas such as information gathering and research, briefing and policy analysis and organising of meetings and general administration. The work of the advisory committees is described in the OFTEL Annual Report for 1995, Part 3, pp 109-130.
representations directly. It has recently embarked on a consultation process designed to evaluate the role of consumer representation in the UK telecommunications industry with a view to evaluating the effectiveness of the existing framework of consumer groups, advisory committees and the complaint handling function of OFTEL itself.

In the case of the water industry, consumer representation has been established on a regional basis. Regional customer service committees review water industry policy, consult with the companies in the industry and endeavour to resolve consumer complaints. There is regular liaison between OFWAT and the chairs of the Customer Service Committees, with more serious complaints (including allegations of breaches of licence conditions) being dealt with by OFWAT itself. The effectiveness of the proposed Customer Service Committees was a matter of some controversy at the time the water industry was privatised, with concerns being expressed that the role of the Director-General in appointing members of the Committees would not ensure the necessary independence of action and could mean that the Director-General would be in a position to influence the stance adopted by the members of the Committees on consumer issues.

The ten Customer Service Committees have issued regular press releases and have worked closely with the Director-General of water supply on a number of issues, including consultation with customers in the fixing of new pricing limits and the issue of increasing competition in the water industry. The national body, the OFWAT National Customer Council (ONCC), has called for compensation to be available to customers where drought conditions affect the availability of water

12. See The Office of Telecommunications: Licence Compliance and Consumer Protection (Report by the Comptroller and Auditor General, National Audit Office, HC 529, 8 March 1993). The consumer services provided by OFTEL are detailed at pp 16-19 of this report, which provides a breakdown of total consumer representations and the types of representation received by OFTEL in the period 1985-1991. For a review of this report see White, "The Office of Telecommunications - Licence compliance and consumer protection - NAO and the aftermath of privatization" (1993) 4 Util LR 53.


14. For a discussion of these arguments see Ernst, supra note 5, pp 23-24.
supply. The ONCC has also been vocal in lobbying OFWAT in favour of reductions in consumer charges in real terms. The ONCC has recently begun holding regional meetings (beginning with a meeting in Newcastle on 3 February 1997) and has generally been active in its role as a consumer watchdog.\(^{15}\) Despite the active role taken by the ONCC and the regional CSCs, there is still room for considerable doubt as to whether this input has served to measurably improve the lot of consumers of water services, an issue which was discussed earlier in chapter 7.\(^{16}\)

In the case of the electricity industry, the former body, the Electricity Consumer Council, recommended its own abolition to Parliament in 1988 on the grounds that adequate regulation of the industry should eliminate the need for a national body representing the interests of consumers and this recommendation was accepted by the government.\(^{17}\) Following subsequent lobbying by the National Consumers Council based on the need for independent representation of the consumer interest, a new national body known as the Electricity Consumers' Committees Chairmen's Group (ECCCG) was established.\(^{18}\)

The ECCCG itself consists of the chairpersons of the fourteen regional electricity consumers' committees (ECCs). The ECCs have been active in various areas, including lobbying OFFER to require adherence by the electricity companies to the timetable for introduction of competition in the domestic electricity industry,


\(^{16}\) See the discussion in part 7.4.5 of chapter 7.


currently due to be instigated in April 1988. The ECCs met with the Minister for Energy in January 1997 to discuss issues such as the structure of the competitive electricity industry in 1988 and have also lobbied the Office of Fair Trading for the adoption of a marketing code to ensure the achievement of an effective competitive market.\textsuperscript{19}

In the case of passenger rail transport, the consumer interest has been represented through newly constituted consumer committees, the Central Rail Users Consultative Committee and the Rail Users Consultative Committees, which came into existence on 1 April 1994. Some of the duties and responsibilities of these new bodies were similar to those of the Central Transport Consultative Committee and The Transport Users Consultative Committees which were in existence prior to privatisation of the industry. However important differences now exist.

First, meetings of the new committees are held in public and the committees are entitled to make representations to the ORR and to OPRAF in relation to passenger rail services and rail franchising issues. The committees can be requested to assist the franchising director in investigating whether franchised operators are complying with their licence standards and can also be asked by the rail regulator to undertake investigations on his behalf.\textsuperscript{20} As well as liaising closely with the committees, the rail regulator has also recently appointed the director of the Scottish Consumer


\textsuperscript{20} For the legislative provisions relating to these committees see ss 76-79 of the Railways Act 1993. The work of the new consumers' committees is described in Central Rail Users' Consultative Committee, Annual Report 1994/95 (CRUCC, London, July 1995), pp 23-24 and in the publication by the RUCs Putting passengers first - Complaints or comments about rail travel -What to do..." (RUCC Publication, London, 1995).
Council, Mrs Ann Foster, as one of three a non-executive directors of the Rail Regulator's Council, the principal advisory body to the regulator.\(^{21}\)

It is perhaps the gas industry in the UK which evidences the best model of consumer representation among the privatised utilities. In the case of gas, an independent Gas Consumers Council was created in August 1986.\(^{22}\) The Council itself has both central and regional offices and staff and has the duty of investigating complaints relating to gas supply. During 1994 GCC consumer advisers answered a record number of requests for assistance by gas customers.\(^{23}\) The GCC has recently advocated a code of conduct for gas suppliers to prevent the adoption of aggressive selling techniques in the period prior to extended competition in the domestic gas market. It has also warned the regulator (somewhat paradoxically in conjunction with the gas companies themselves) that the headlong rush towards full competition in the gas supply industry may produce administrative mayhem.\(^{24}\)

The GCC has undertaken useful initiatives in areas such as promotion of gas safety (particularly in relation to steps to prevent domestic carbon monoxide poisoning) and has consistently urged British Gas to maintain and improve the special services which the company offered for older or disabled customers. The influence of the Council is to be extended to companies operating in the extended competitive market

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22. For the background to the creation of the GCC see Ernst, supra note 5, p 11.

23. According to the GCC Annual Report 1994, at p 4, there were 126,040 requests for assistance during 1994, an increase of 38% over the 1993 total. This meant that the 12 regional offices of the GCC each received on average some 482 inquiries per day. According to this Report (at p 6), the main cause of consumer dissatisfaction concerned service and repair work to domestic heating systems and complaints about service contract conditions and marketing activities. There were also significant increases in complaints over the accuracy of gas accounts and in relation to payment of gas bills through the Department of Social Security deducting the amount due from income support payments. Although gas complaints rose in 1995 and again in 1996 (by a figure of 103% in that year), they appeared to have tapered off in the first three months of 1997. See article in The Times, 12 May 1997: "Gas Complaints Past their Peak". Offset against this positive development was the news that the level of disconnections for non-payment of gas bills had begun to increase. See article in The Times, 8 September 1997: "Gas Disconnections Up in Competitive Market".

24. See article in The Times, 31 January 1997, "Gas-supply code of conduct urged". On the subject of the timetable for competition see article in The Times, 6 August 1997: "Warning for Regulator - Ease off the Gas".
and it seems likely that the GCC's activities will continue in importance. The GCC seems generally to have been more successful than other consumer bodies in representing the interests of consumers of gas services in their particular industry.

The National Consumer Council (NCC), an independent national consumer body whose Council members are appointed by the Department of Trade and Industry, was interviewed in the course of research for this thesis. The NCC has tended to favour the model of an independent consumer representation body along the lines of the model of the Gas Consumer Council, with its own resources and staffing and which is independent of the industry regulatory body. Some NCC staff would prefer a more structured system allowing for intervenor funding and possibly also formal hearing regimes along the lines of the US model. The NCC itself has participated in the regulatory processes and has made submissions in areas such as competition, pricing and service levels in both the gas and electricity industries. It is also active in investigating revisions to the RPI-X pricing formulae, such as the issue of whether sliding scale or benefit sharing regulatory formulae should be introduced.

11.2.2 Areas of Strength and Weakness

It is appropriate at this point to analyse some areas of strength and weakness in the UK system of consumer representation outlined above. On the credit side, the regional system of consumer representation in the privatised utility industries has provided a beneficial mechanism for resolving consumer complaints through informal mediation between consumer bodies and the utility companies themselves. The consumer organisations have been made up of a variety of representatives of different classes of consumers, so that breadth of coverage has been achieved in


26. See the NCC publications, *Electricity Distribution - Price control, reliability and customer services: Response to Offer*; (NCC Publication PD 01/E/94, February 1994); *Competition and Choice in the Gas Market - Response to DTI and Ofgas* (NCC Publication PD 29/E3a/94, August 1994); *Public Utilities and Domestic Consumers - Background paper for a European seminar on public utilities* (NCC Publication PD 06/E/95, March 1995).
relation to representation. The committees themselves undertake various consultation exercises and are generally co-ordinated on a national basis.

As against these positive aspects, a number of disadvantages are also evident. First, the fact that (apart from the gas industry) the consumer bodies are closely identified with the industry regulator, particularly in terms of the appointment process, brings into question their autonomy and independence. This was not a concern which was restricted to consumer groups. The Energy Committee of the House of Commons expressed a similar view in relation to the system of consumer representation in the electricity industry.

Another area of concern has been difficulties in communicating information to the public about the structures established to promote the consumer interest. Empirical studies have highlighted difficulties of this kind in relation to the water industry, despite efforts from OFWAT to publicise the available structures.

27. As the National Consumer Council put in its publication *In the absence of competition: A consumer view of public utilities regulation* (HMSO, London, 1989) at pp 3-4: "It is clear that the regulator cannot be the sole guardian both of the general public interest and of the specific interests of the industries' consumers, even though part of his role may be the enforcement of specific regulation designed to protect the industries' consumers." The Consumers Association put the matter in a similar way in its submissions on the Water Bill 1989. See *The Water Bill* (Consumers Association, London, 1989) at p 9: "Consumer representation is...a partisan activity. Regulation and consumer advocacy, are not, therefore the same thing."

28. See *Second Report from the Energy Committee of the House of Commons* (HC 113, 1991-92, HMSO, London) at para 138: "We do not regret the recommendation we made in 1988, but we now see more need for a national consumer voice than the Director General himself. The committees' reports appended to the Director General's annual report are disappointingly thin, lacking any overview or comparison between regions. At present the chairmen of the 14 electricity consumers' committees (including those in Scotland) meet regularly with the Director General to form the National Consumers' Consultative Committee, and we recommend that the work of the National Consumers' Consultative Committee be developed and expanded on an arm's length relationship with the Director General, and that the Committee publish an annual report separate from the Director General's containing the reports of the individual committees and commenting on the Director General's work where appropriate. We also recommend that the Director General consider whether regional committee members are receiving sufficient training and information."

29. See Saunders & Harris, *Privatisation and Popular Capitalism* (Open UP, Buckingham, 1994) at p 71: "Unfortunately, however, few customers seem to know about the CSCs. A survey commissioned by Ofwat in 1991 found that few people even knew of their existence and activities, let alone the role of the CSCs. While 37% of the population was apparently aware that an organization had been established to regulate prices and look after the interests of customers, only 6% of them (or just 2% of the population as a whole) could actually name it (Ofwat 1992, p 68). This low level of public awareness seems no better than the situation before privatization - Customer Services Committees have replaced Consumer Consultative
There is also reason to doubt the effectiveness of the existing structures. The experience of lobbying of the regulator, particularly in the electricity and water industries, has not given rise to excessive optimism that the consumer interest has been well served through the existing methods. This has been evidenced by the comparatively high level of customer dissatisfaction, particularly in the water industry. There is no doubt that structured procedures under which the industry regulator is required to incorporate the views of consumer organisations in reaching a regulatory determination (as in the US public utility model) have the undeniable advantage that the regulator is unable to avoid the issue and cannot merely pay lip service to submissions by consumer organisations. It may be that some of these difficulties will be resolved when the utility markets become subject to a greater degree of competition in 1998. However, it is doubtful whether the need for effective methods of consumer redress will ever disappear completely.

11.3 A Commonwealth Perspective

11.3.1 The Australian Experience

This part of the chapter considers the divergent experience in two Commonwealth jurisdictions, Australia and New Zealand, in relation to protection of the consumer interest in economic regulation. In Australia, despite increasing deregulation of industry in areas such as electricity and telecommunications, there has nevertheless been strong emphasis placed on the need for relatively formal and structured regulatory intervention. In New Zealand, by contrast, the emphasis on a light handed regulatory regime, involving the general competition law authority, the Commerce Commission, has led to a somewhat different structure being adopted.

 Committees, but there are few people outside the industry who know about either! This is confirmed by our survey, in which we asked consumers to whom they would complain if a grievance was not resolved by their water supplier. In 1989, before the industry was privatized, just 3% of consumers thought of approaching the CCCs which had by then been in existence for six years."
Recent regulatory developments in the Australian telecommunications area have been canvassed in previous chapters. As the discussion in those chapters noted, wide ranging legislation has recently been passed by the Australian House of Representatives in relation to the restructuring of the telecommunications industry and associated regulatory requirements. The transferring of competition policy matters to the ACCC is a move which parallels to some extent the New Zealand approach of regulation involving the Commerce Commission, the equivalent New Zealand competition law body.

The Australian initiative illustrates the fact that competition policy matters in deregulated industries such as telecommunications may be relatively complex and may need to be dealt with by a specialist competition law body separate from the industry regulator itself. (Such an approach has not yet been adopted in the United States. As the discussion of the Telecommunications Act 1996 in part 10.7 of chapter 10 showed, the FCC has retained responsibility for promoting the competitive functioning of the deregulated US telecommunications industry, especially in relation to issues of interconnection and the provision of universal service.) Similarly, in Britain, as the discussion in chapter 9 has shown, OFTEL has continued to have responsibility for enforcing the observance of fair trading in the UK telecommunications industry.

The Australian approach has shown that, even in a deregulated and hopefully more competitive industry environment, the need for continuing regulatory intervention and oversight by a specialist competition law body has continued to be recognised by the legislature. This illustrates that even with deregulation there may still be areas where regulatory intervention is necessary, particularly in relation to access to an

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30. See the discussion in part 4.6.5 of chapter 4 and part 7.3 of chapter 7.

31. To recapitulate, the Australian Communications Authority Bill 1996 established a new body known as the Australian Communications Authority with effect from 1 July 1997. This body took over aspects of broadcasting regulation previously carried on by the Spectrum Management Agency in relation to radio broadcasting and the Australian Telecommunications Authority (AUSTEL) in relation to telecommunications matters. The merged body is responsible for all aspects of radio and telecommunications regulation, apart from competition policy matters in those industries, which has become the responsibility of the Australian Competition and Consumer Commission (ACCC).
industry network where a dominant incumbent would be in the position of being able to dictate terms of interconnection in the absence of such regulatory oversight.

11.3.2 The New Zealand Experience

In New Zealand, the experience with a deregulated industry environment under the general oversight of the Commerce Commission has not been entirely satisfactory, so far as promotion of the consumer interest is concerned. The following observations deal with the New Zealand experience in the telecommunications, gas and electricity industries.

In relation to telecommunications, the experience of Clear Communications Limited in gaining access to Telecom New Zealand's network and the associated marathon litigation extending over several years, has been described in some detail in chapter 4.\textsuperscript{32} As that chapter detailed, it took over five years for agreement to be reached on the terms of interconnection between the two industry participants, a task which was accomplished far more expeditiously in the United Kingdom where the imminent possibility of regulatory or legislative intervention reminded the UK duopoly participants of the need for reasonable co-operation on interconnection issues.\textsuperscript{33}

As the discussion later in this chapter will show, even the negotiation of a relatively comprehensive settlement agreement dealing with interconnection issues has not served to eliminate the need for ongoing litigation in the courts between Clear and Telecom, even including current litigation over the scope of the dispute resolution provisions in the settlement agreement itself.\textsuperscript{34} Even now, New Zealand telephone consumers are still faced with some of the highest comparative line rentals and toll

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\textsuperscript{32} See the discussion in parts 4.6.2 to 4.6.4 of chapter 4.

\textsuperscript{33} Interconnection between the UK duopoly participants was in fact achieved during 1985 in a period of about six months!

\textsuperscript{34} See article in the \textit{NZ Herald}, 12 June 1997: "Govt input wanted to prevent phone rows", reporting that relations between Telecom New Zealand and its three principal competitors in New Zealand, BellSouth, Clear and Telstra New Zealand, remained acrimonious on the issue of setting interconnection guidelines for access to Telecom's network.
call rates in the western world, despite the ostensible benefits of industry competition.\textsuperscript{35}

In relation to the gas industry, similar difficulties with long term supply contracts to those which have bedevilled the UK gas industry in recent years have existed. The Commerce Commission has from time to time expressed concern about anti-competitive practices in the gas industry, including provisions of wholesale gas contracts requiring utilities to acquire all of their gas from the Natural Gas Corporation (NGC), a restriction on NGC from competing with utility companies and a requirement that new gas delivery points be mutually agreed, with accompanying disincentives to arrangements for delivery outside the current distribution systems of the existing utility companies.\textsuperscript{36}

The Commerce Commission has recently warned the gas industry of possible court action for breach of the Commerce Act. The need for such a warning arose out of the Commission's increasing frustration that new gas supply contracts were not being negotiated within a reasonable time frame.\textsuperscript{37}

However, it is in the electricity industry that the greatest abuses have become evident, so far as the consumer interest is concerned. Despite a theoretically deregulated

\textsuperscript{35} See \textit{NZ Herald}, 8 June 1997, "Why we could do with a little light regulation": "Telecommunications costs are another example. Toll calls in the United States and Britain are generally cheaper than here by up to 50 per cent. A $5 off-peak toll call in Britain will buy you more than an hour to any domestic location. Cellular calls are cheaper in Britain than anywhere."

\textsuperscript{36} For a discussion of the potentially anti-competitive characteristics of long term gas supply contracts see the judgment in \textit{Shell (Petroleum Mining) Company Limited & anor v Kapuni Gas Contracts Limited and Natural Gas Corporation of New Zealand Limited} (1997) 7 TCLR 463.

\textsuperscript{37} See Commerce Commission Newsletter, \textit{Fair's Fair}, Issue No. 44, February/March 1997, p 9, recording remarks by the Commission's Chief Investigator, Network Industries Unit, David Taylor, to a gas industry conference held in Auckland, New Zealand on 18 February 1997: "The Commission did of course expect adjustments post-deregulation to take some time and, being commercial negotiations, it is natural that the parties have different incentives in approaching those negotiations. However, the Commission is increasingly frustrated that new contracts are not in place. Therefore, it is appropriate to remind the parties of one incentive that they share in common, being that they are all potentially subject to the remedies under the Act. Further the longer the negotiations the greater the potential detriment to consumers. In short all the parties have responsibility to achieve a solution. // As some of you are aware, the Commission is in the middle of discussions with utilities, assessing the progress that has been made and proposed. The Commission needs to reach a view as to the likelihood of a solution within a reasonable timeframe (by that we mean months not years)."
electricity supply market, as of September 1996 over 95 per cent of total electricity requirements were still being supplied by incumbent suppliers in each power supply area. The comparatively small and geographically dispersed population of New Zealand has generally rendered it uneconomical for competition to take place at the local level. Customers therefore have had little choice of supplier in practice and have also been subject to standard form contracts which were weighted against their interests. A government report released in January 1997 highlighted a number of areas of abuse.  

The report noted that the forty power companies operating in New Zealand had universally one-sided domestic supply contracts, some of which contained terms which were relatively draconian, and which tended to disadvantage consumers. For example, many of the contracts did not impose any obligations on power companies to test the accuracy of their meters, or to consult with customers in relation to contract changes or disconnection. Similarly, many of the contracts required customers to pay for rectifying problems with supply, even where these were caused by the power company. A number also required customers to pay for power even where this had not been used (for example where system leakage or short-circuiting had occurred). Most of the contracts lacked fair and efficient dispute resolution procedures. Power prices had increased by some 30 per cent per year for


39. The authors of the report concluded, ibid pp 44-44, following their examination of the contracts used by the power companies: "Our analysis has revealed that the standard form contracts being offered to domestic customers fall below what would be a fair standard form contract in a competitive market. Although the legislative framework allows, and indeed encourages power companies to provide contracts which meet consumers' legitimate rights and interests, companies have not yet responded to this in an appropriate way. Some power companies are undertaking some positive customer initiatives but these customers are in a minority. // A significant improvement in the standard of terms and conditions offered to domestic customers is required before customers across New Zealand can benefit from a fair contract which reflects their legitimate rights and interests."
residential customers over the past five years at a time when the annual rate of inflation was less than three per cent.40

The report recommended the adoption of industry benchmarks designed to balance the rights and interests of consumers and suppliers of electricity. The Ministry of Consumer Affairs recommended the adoption of the standards by power companies either individually or through an industry wide initiative based on a self regulatory approach.41 To date the report and its conclusions have been greeted with a considerable amount of rhetoric by New Zealand government ministers with little discernible effect.42 One is entitled to be justifiably sceptical of the ability of light handed regulation based on persuasion and information disclosure to control dominant firms in a natural monopoly situation, a scepticism which has recently been shared in relation to the New Zealand electricity market by the International Energy Agency of the OECD.43

40. See article in The Dominion (Wellington, New Zealand), 11 June 1997: "Veteran state servant switches to powerful role", reporting on the activities of the power companies' industry group, the Electricity Supply Association.

41. See the discussion in part 6 of the report, supra note 38, pp 58-70.

42. See for example article in The Dominion, 14 May 1997: "Bradford bemoans firms' behaviour"; The Independent, 16 May 1997: "Crack down on power monopolies". See also MacAlister, "Power Failure. Why isn't Competition Working in the Electricity Sector" Management, June 1997, p 33 at p 36: "Until now the Government has followed a de facto regulatory policy, relying on the Commerce Act and a legislative requirement - the Electricity (Information Disclosure) Regulations - that power companies provide extensive data on the performance of their networks to the Ministry of Commerce. The theory is that disclosure will identify those companies abusing their position and shame them into improving their performance. // To date, however, there is little evidence to show that such a light-handed approach is working. Although various energy ministers have been made aware of certain anti-competitive practices and the Commerce Commission - in its role as competition watchdog - has barked about anti-competitive behaviour, there's been no bite."

43. See Energy Policies of IEA Countries: New Zealand 1997 Review (International Energy Agency of the OECD, OECD Publications Service, Paris, 1997), p 73: "In the absence of an industry-specific regulator, the primary onus for drawing attention to and instigating action under the Commerce Act against potential monopoly profits and anti-competitive behaviour such as over-charging for use of the network is placed on individual plaintiffs, though the Commerce Commission as the economy-wide regulator has a legal mandate to initiate action. The costs of individuals trying to take action are likely to be high. Uncertainties arising from a recent court ruling in the telecommunications sector may also deter action against anti-competitive behaviour and encourage distributors to charge excessive use-of-systems tariffs...It is also unclear whether the sanctions for non-compliance with the information disclosure regulations or delays in disclosing information are adequate." In response to criticisms of this kind the New Zealand government has extended the information disclosure
The experience with the New Zealand electricity supply industry illustrates that the gap between theory and practice in a deregulated industry may be a wide one. Where there is insufficient incentive for a new market entrant to participate in a deregulated market, the consumer interest may inevitably suffer both in relation to levels of pricing and standards of service and performance. It is perhaps no coincidence that the Consumers' Institute of New Zealand has been investigating the use of an industry-funded model of consumer advocacy, initially in relation to representation of the consumer interest in the electricity and telecommunications industries.44 This proposal mirrors to some extent the use of consumer protection agencies in US state regulatory practice, as described in chapter 10.

The experience of both Australia and New Zealand has shown that while genuine industry competition may bring about improvements in the consumer interest, the need for effective regulatory supervision and oversight does not necessarily diminish in a competitive industry environment. Market failures and distortions, coupled with the incentive for dominant firms to achieve or maintain a position of market power, simply mean that the need for regulatory intervention continues, albeit possibly with a different focus than in the case of regulation of natural monopolies. It seems that preservation of the consumer interest, like liberty, is likely to require eternal vigilance.

11.4 Adversarial Procedures - Problems and Solutions

11.4.1 Funding and Access to Justice

Our study of the US regulatory process in chapters 6 and 10 has shown that an essential aspect of the adversarial treatment of regulatory issues is the availability of funding mechanisms to allow third party interest groups such as consumers to participate fully in such processes. In the US context this has been accomplished by...
a system of state consumer protection agencies with specialist expertise and independent funding. Wide discretion to allow intervenors to participate in regulatory processes has also permitted independent self-funded consumer groups to play a part in such processes. Under the US system costs are generally not awarded against unsuccessful intervenors and there is therefore no cost disincentive discouraging participation in such processes.

The position in Britain and in Commonwealth jurisdictions is very different. Rules of standing are generally more restrictive and a significant costs sanction attaches to unsuccessful parties to litigation, including representative organisations purporting to act in the public interest. There is also no general tradition of public interest litigation as such, although more recently pressure groups have begun to utilise the litigation process more frequently, especially through the use of judicial review applications.45

The foregoing concerns about the cost and effectiveness of the adversarial process in civil litigation have given rise to much soul searching, both in Britain and elsewhere in the Commonwealth.46 Various solutions to the problem have been suggested. These have included permitting the funding of civil litigation on a contingency

45. In the regulatory context many judicial review applications have been brought against regulators by industry participants rather than third party groups. This has particularly been the case in areas such as financial services regulation and in relation to the privatised utilities. One notable recent exception has been the (ultimately) successful judicial review application by the Save Our Railways lobby group in relation to aspects of rail privatisation. See the discussion of this litigation in part 8.3.5(iii) of chapter 8.

46. One should not forget of course that the system has undergone considerable improvement since the nightmarish processes of the Court of Chancery last century. As Charles Dickens wrote of that court in his famous passage in Bleak House (Penguin Books, London, 1985, first published 1853) at p 51: "This is the Court of Chancery; which has its decaying houses and its blighted lands in every shire; which has its worn-out lunatic in every madhouse, and its dead in every churchyard; which has its ruined suitor, with his slipshod heels and threadbare dress, borrowing and begging through the round of every man's acquaintance; which gives to monied might the means abundantly of wearying out the right; which so exhausts finances, patience, courage, hope; so overthrows the brain and breaks the heart; that there is not an honourable man among its practitioners who would not give - who does not often give - the warning, 'Suffer any wrong that can be done you, rather than come here!' ". For a summary of some of the present failings of the British system of civil justice see "Trial and error", The Economist, 14 January 1995, p 29; Swanson, "A Review of the Civil Justice Review: Economic Theories Behind the Delays in Tort Litigation" [1990] CLP 185; Civil Justice on Trial - The Case for Change (Heilbron Joint Committee of the Bar Council and the Law Society, London, 1993); Glasser, "Solving the Litigation Crisis" (1994) 1 The Litigator 14; Zuckerman, "A Reform of Civil Procedure - Rationing Procedure rather than Access to Justice" (1995) 22 JL & S 155.
basis, together with various procedural reforms to the civil justice system such as case management and judicial supervision of proceedings, although at present the extent to which these proposals are likely to be implemented remains uncertain. Contingency fees are particularly useful in areas such as personal injury litigation, where there is a reasonable prospect of obtaining a lump sum award either in settlement or from a trial. However, in the case of regulatory proceedings, where the financial benefits may be thinly spread over a large number of individual participants, such as consumers, and often extend well into the future, they are much more difficult to implement.

47. Contingency fees were first permitted in 1996 under certain conditions for litigation in English courts after much discussion on the subject. For a description of these developments see article in The Independent, 23 April 1995: "LA law comes to Britain with 'no win, no fee' plan"; Pulman and Napier, "Conditional views", Law Society's Gazette, 26 April 1995, p 16. Other Commonwealth jurisdictions such as New Zealand have also permitted litigation to be funded on a contingency basis. This is one area in which there is very little professional consensus, particularly given the fact that contingency fees (together with the absence of a cost sanction against unsuccessful parties) have been blamed for much of the contemporary explosion in civil litigation in the United States. The literature on this subject is vast. For some examples see Danzon, "Contingent fees for personal injury litigation" (1983) 14 Bell Jnl Econ 213; Paterson, "Contingent fees and their rivals" Scottish Law Times, 10 February 1989, p 81; Tan, "Champertous contracts and assignments" (1990) 106 LQR 656; Gravelle and Waterson, "No Win, No Fee: Some Economics of Contingent Legal Fees" (1993) 103 Econ Jnl 1205. For a fascinating, recent article on the contingency fee incomes of leading US trial lawyers see article in The Times, 18 February 1997, "The multimillion fees", estimating the 1996 earnings of one leading US trial lawyer at a staggering US$90 million!

48. In the United Kingdom attention has recently focused on these issues after the publication of Lord Woolf's Review of the Civil Justice System in England and Wales, 1994-6 (HMSO, London, 1996) (following the publication of Lord Woolf's earlier interim report on the subject in 1995), which recommended a more co-operative and less adversarial system of civil litigation involving simpler and more expeditious procedures, closer judicial supervision of litigation and increased responsibility on the part of the courts for the speedy and efficient management of cases. Stage I of Lord Woolf's inquiry was the subject of a wide ranging set of essays in Zuckerman and Cranston (eds), Reform of Civil Procedure - Essays on 'Access to Justice' (Clarendon Press, Oxford, 1995). In addition, ADR procedures are to be encouraged and limits on the scope of discovery and the use of expert evidence are recommended. These procedures are to be enforced by increased cost sanctions, including awards of costs against litigants who have acted unreasonably or oppressively, even where the rules of procedure have been literally complied with. It remains to be seen whether these recommendations will be implemented.

49. This is illustrated by the fact that the UK experience to date with the use of contingency fees since their introduction in 1996 has largely been confined to personal injury and medical negligence cases. See for example article in The Sunday Times, 11 May 1997: "Victims of medical negligence pursue remedy for justice", recording that about 20 contingency fee cases alleging medical negligence have proceeded since the introduction of contingency fees. See also article in The Sunday Times, 11 May 1997: "Hidden bills for losing no win, no fee action", drawing attention to the need for contingency fee plaintiffs to take out litigation
There is no doubt that the present structure of civil litigation and its associated procedures, particularly the quite onerous obligations of discovery in major civil cases, impose major cost burdens on the parties. As is evident from the literature, there is certainly no shortage of predictions as to likely future developments in the civil litigation area, though the direction of change is still a matter for debate.

Similar developments have been evident in Commonwealth jurisdictions. In New Zealand, a comprehensive system of judicial case management in relation to civil litigation was introduced in 1994. This provided for the allocation of civil litigation to one of four tracks, known as the intermediate track, swift track, standard track and complex track, with regular directions conferences designed to monitor progress to trial, and also options for resolution of litigation by ADR procedures.

In Australia, case flow management has also been a feature of both federal and state civil procedure in recent years. Such initiatives, of course represent something of a philosophical shift in the role of judges from being passive arbiters of disputes presented to them by litigants to being active participants in ensuring the expeditious protection insurance against the possibility of having to pay the defendant's legal costs in the event that the case is lost at trial.

50. As every commercial litigation solicitor knows, only a small proportion of the documents discovered in major commercial litigation eventually end up forming part of the trial bundle, despite the enormous cost and expense involved in collating and listing all documents which might have some conceivable relevance to the issues arising in the proceeding. In some recent cases the courts have endeavoured to place limitations on the scope of discovery in major commercial litigation. See for example Dolling-Baker v Merrett [1990] 1 WLR 1205; R v Chief Constable of the West Midlands Police, ex parte Wiley [1994] 3 WLR 433; Taylor v Anderton and the Police Complaints Authority [1995] 1 WLR 447. For a general discussion of the problem see Passmore, "Controlling a Juggernaut" (1995) 92 Law Society's Gazette, 25 October 1995, p 20; Mackie, "Discovery in Commercial Litigation" in Zuckerman and Cranston (eds). Reform of Civil Procedure - Essays on 'Access to Justice', supra note 48.


52. See Case Management Pilots in the High Court (Practice Note, Eichelbaum CJ, 24 March 1994).

Other suggestions for reform of the adversarial process have also been made, including placing an increased emphasis on the need for ethical and reasonable conduct by litigation lawyers by emphasising more strongly lawyers' obligations to the court and the judicial system, as opposed to obligations to their clients. In the state of Victoria, radical proposals allowing for compulsory reference of litigants to mediators have now been operating for several years. The Australian Law Reform Commission has recently published an issues paper dealing with the subject which has taken a critical stance of the adversarial system as it operates in Australia.

These proposals have not been uncontroversial. They have attracted criticism both in the United Kingdom and in Australia, often based on opposing perceptions of the comparative efficiency of judicial management of litigation as compared to the conduct of litigation by the parties themselves. As some writers have pointed out,

54. These opposing models of judicial decision making have been the subject of academic analysis going back some years. See for example Fuller, "The Forms and Limits of Adjudication" (1978) 92 Harv LR 353; Chayes, "The Role of the Judge in Public Law Litigation" (1976) 89 Harv LR 1281; Weiler, "Two Models of Judicial Decision-Making" (1968) 46 Can Bar Rev 406.

55. See for example Honourable Justice Ipp, "Reforms to the Adversarial Process in Civil Litigation - Part I" (1995) 69 Aust LJ 705. At p 730 Justice Ipp commented: "It is strongly arguable that the time has come for lawyers' obligations to the court (and the system) to be defined in specific terms so as to ensure the speedy and efficient administration of justice. If the profession does not lay down appropriate standards of conduct for lawyers in litigation, and enforce them strictly, it is inevitable that there will be legislative intervention to impose appropriate legal obligations upon lawyers, with powers given to the courts to enforce them."


58. See for example Zander, "Why Lord Woolf's Proposed Reforms of Civil Litigation Should be Rejected" in Zuckerman and Cranston (eds), supra note 48, who takes the view that the Woolf Report proposes solutions which are simplistic and ill-conceived and places too much blame on litigation lawyers for failings which are inherent in the system itself. In similar vein, see Zander, "Does Case Management Work?" [1997] NZLJ 151, drawing attention to US studies which suggest that judicial case management has had the effect of significantly increasing litigation costs without providing a corresponding benefit on the same scale to litigants, so that serious issues of access to justice began to emerge. In Australia, similar doubts have been expressed as to whether reforms to the adversary system generate more problems than answers. See for example Ackland, "Law reform proposal on shifting sands" Australian Financial Review, 2 May 1997; Ipp, supra note 55, p 721: "The costs of managerial judging are unknown. It is said that collecting data, meeting with parties, holding interlocutory hearings and concentrating on other managerial duties may be using time better
the adversary system of litigation has some inherent strengths which should not be overlooked. Perhaps the most important of these is the fact that the self interested involvement of motivated litigants provides a forum which is conducive to isolating the factual and legal issues in dispute and resolving them either at or prior to trial.59

It is of course possible to modify the existing structure of adversarial proceedings in civil cases without abandoning the benefits of the system altogether. In the case of expert evidence in competition law and regulatory cases, some progress has been made in jurisdictions such as Australia and New Zealand towards streamlining the use of such evidence at trial. A recent decision of the Australian Trade Practices Tribunal in October 1995 has shown that it is possible to introduce streamlined procedures designed to encourage expert witnesses in such cases to define more narrowly their respective areas of difference without the need for exhaustive cross examination on the whole of their evidence.60 A similar initiative has recently been adopted in New Zealand in a substantial competition case.61

completed on adjudicating cases. Productivity is difficult to measure. How does one compare the use of a judge's time for case management purposes in any given week resulting in the disposition of say 10 cases, and the use of that time to try a three day case and to write a judgment that is affirmed on appeal and which affects the lives of hundreds of thousands of persons in the community. The fact is that standards designed to measure achievement in other fields cannot be transferred into the courtroom."

59. See for example Simon, Reason in Human Affairs (Basil Blackwell, Oxford, 1983) at p 90: "Adversary proceedings are like markets in reducing the information that participants must have in order to behave rationally. Thus they provide a highly useful mechanism for systems in which information is distributed widely and in which different system components have different goals. Each participant in an adversary proceeding is supposed to understand thoroughly his own interests and the factual considerations relating to them. He need not understand the interests or situations of the other participants. Each pleads his own cause, and in doing so, contributes to the general pool of knowledge and understanding."

60. See Re Queensland Independent Wholesalers Ltd (1995) ATPR 41-438 (Australian Trade Practices Tribunal, 17 October 1995). The Tribunal noted at p 40,925 of the report of its decision: "Four expert witnesses in the field of economics furnished statements and were examined orally before the Tribunal at the hearing. The Tribunal adopted the following procedure with respect to expert witnesses, for the purpose of obtaining the maximum benefit from their evidence and removing them from the adversary process so far as possible:

- At the conclusion of all the evidence (other than the evidence of the experts) and before the commencement of addresses, each expert was sworn immediately after the other and in turn gave an oral exposition of his or her expert opinion with respect to the relevant issues arising from the evidence.
- Each expert then in turn expressed his or her opinion about the opinions expressed by the other experts.
- Counsel then cross-examined the experts, being at liberty to cross-examine on the basis (a) that questions could be put to each expert in the customary fashion (i.e. one
Such abbreviated procedures, which serve to narrow and define the matters in contention, could usefully be applied to regulatory hearings involving evidence from expert economists, accountants, engineers and other professionals. Initiatives of this kind would greatly assist in reducing the burden of adversarial litigation and would enable third parties such as consumer groups to play a more meaningful role in such processes without being completely overwhelmed by the sheer logistics of the exercise.

Apart from these considerations, several preconditions are of course necessary for adversarial procedures to function adequately. Leaving aside the issue of access to funding and specialist expertise, rules of standing or intervention must be sufficiently liberal to enable all interested parties to participate in the process. This is particularly the case with polycentric disputes such as those which are often found in regulatory proceedings.\textsuperscript{62} This aspect will be discussed further below.

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after the other, completing the cross-examination of one before proceeding to the next), or (b) that questions could be put to all or any of the experts, one after the other, in respect of a particular subject, then proceeding to the next subject. Re-examination was conducted on the same basis.

In the result we gained assistance from the evidence of the experts. Their oral expositions and examinations occupied only three and one-half hours. // The proceeding was conducted before us by counsel and solicitors, the parties and the Commission with considerable expedition and efficiency, and we wish to record our gratitude to them.\textsuperscript{61}

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\textsuperscript{61} See the Kapuni case, \textit{supra} note 36 at p 160, in which the court noted: "We are greatly attracted to the procedure adopted recently in the Australian Trade Practices Tribunal in \textit{Re Queensland Independent Wholesalers Limited} (1995) ATPR 41-438. Lockhart J as Chairman of the Tribunal - one of Australia's most experienced Judges in competition law - invited four economists from competing sides to agree on common areas and then to debate in front of the Tribunal their points of contention." A similar approach was approved by the New Zealand Court of Appeal in \textit{Tru-Tone Ltd v Festival Records Ltd} [1988] 2 NZLR 352 at 357: "The evidence [of economists] was given at length, both by affidavit and orally at the hearing. A perhaps unusual but valuable feature is that the High Court invited each economist in turn (and with prior notice) to articulate the differences in opinion between them in the area of their expert assessment as economists of the factual issues in the case."

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\textsuperscript{62} See Simon, \textit{supra} note 59, pp 90-91: "In order for adversary proceedings to work well, the right to become a party to any process must be defined broadly enough so that all who will be significantly affected by the decision have an opportunity to contribute their evidence and voice their preferences. In our own society the notion of interdependence has been increasingly recognized; the courts have steadily broadened the rules determining who may be heard in any particular case, even one that beings as a dispute between two specific parties. In this way, the courts take account of externalities analogous to those that arise in the workings of a market system."
This is not so say that reforms to the adversary process are not necessary or are not overdue. However, when assessing the merits of suggestions for reform, it should not be overlooked that adversarial procedures provide a convenient and well tested means of facilitating the resolution of disputes on a rational basis. In the regulatory arena, such processes have the added advantage of ensuring that the regulatory authority must deal expressly with the contentions of the opposing parties and must produce a decision which takes account of the positions advanced by the participants. While the system is clearly far from perfect, it does have discernible advantages of transparency, convenience and compulsion which should not be lightly discarded.

11.4.2 Actions for Private Enforcement

In considering how the consumer interest in the regulatory process can most effectively be furthered, some thought needs to be given to sources of legal redress. There is of course the remedy of judicial review. However, in the UK context, this remedy is relatively narrowly focused and tends to emphasise procedural rather than substantive deficiencies. While the remedy of judicial review can be an effective means of challenging regulatory decisions in some contexts, it has discernible shortcomings so far as empowering consumers in a more general fashion is concerned.

This raises the issue of whether an action in tort might be available to consumers whose interests have not been adequately taken into account in the course of the process of regulatory decision making in the economic area. Veljanovski has suggested the possibility of defining an action in tort for breach of a regulatory obligation, but so far this idea has attracted little interest or support, although statutory torts have been created in various other areas.63

63. See Veljanovski, The Need for a Regulatory Charter (European Policy Forum, London, 1993). For a recent example of an express statutory tort see the right to bring civil proceedings for damages for harassment which was conferred by s3 of the Protection from Harassment Act 1997 (1997, c40), which took effect on 16 June 1997 in accordance with The Protection from Harassment Act 1997 (Commencement) (No 2) Order 1997 (SI 1997 No 1498).
The issue arises as to whether an action in tort for breach of statutory duty is available to consumers who claim to be disadvantaged as a result of the regulatory process. There are significant problems standing in the way of this concept. To begin with, the courts have been reluctant to recognise that the statutory duties of public bodies give rise to private rights of action which are available to individual litigants. The cases indicate that it is not sufficient for a plaintiff to establish that there has been a breach of statutory duty in itself. A cause of action based on the tort of breach of statutory duty only exists if the court accepts, as a matter of statutory interpretation, that the statutory duty relied upon has been imposed to protect a limited class of the public and that it was the intention of Parliament to allow the members of that class to enjoy a private right of action in tort for the breach of that duty.

Courts have generally looked at whether the statute provided other remedies for breach (such as criminal sanctions) as well as to the true construction of the statute as a whole. It is also necessary to demonstrate that a breach of the particular statutory requirement gives rise to a right to claim damages, a matter which has caused plaintiffs some difficulty in many of the reported cases.

In addition to these legal difficulties, in the UK, the industry regulators have been given a wide discretion under their particular statutes, allowing them to pursue their regulatory objectives largely as they see fit. It would therefore be very difficult for participants in the regulatory process to be able to assert that a particular regulatory

64. For a discussion of these issues see cases such as Read v Croydon Corporation [1938] 4 All ER 631; Evenden v The Council of the Shire of Manning (1929) 30 SR (NSW) 52; Phegan, "Breach of Statutory Duty as a Remedy Against Public Authorities" (1974) 8 Univ Qd LJ 158, which reviews the authorities in this area. For a general discussion of the tort of breach of statutory duty see Stanton, Breach of Statutory Duty in Tort (Sweet & Maxwell, London, 1986); Arrowsmith, Civil Liability and Public Authorities (Earlsgate Press, Winteringham, 1992), chapter 7.

65. See the leading cases of Cutler v Wandsworth Stadium Ltd [1949] 1 All ER 544; Lonrho Ltd v Shell Petroleum Co (No 2) [1981] 2 All ER 456 and X (minors) v Bedfordshire County Council [1995] 3 All ER 353.

decision has not adequately taken account of their particular interests in terms of the statutory provisions establishing the regulatory framework.

This analysis shows that the prospect of consumers, either individually or as organised bodies, making headway from an action in tort in this context is minimal. This serves to emphasise all the more the importance of providing adequate structures enabling consumers to participate meaningfully in the regulatory process.

11.4.3 Some Problem Areas - Standing and Costs of Intervention

In considering how consumers can participate in regulatory processes in a structured and coherent fashion, some thought needs to be given to legal issues such as standing and costs of intervention. The examination of US regulatory processes in chapter 10 showed that liberal views of standing adopted by tribunals such as the US public utility commissions assisted consumers to participate in these proceedings. Similarly, while costs were not often awarded in US regulatory proceedings in favour of intervenors, neither was there a disincentive to intervenor participation arising out of the prospect of significant costs awards against such parties.

In Britain and Commonwealth jurisdictions the situation is very different. To begin with issues of standing, these have undergone some degree of liberalisation in recent years. However, technical arguments over standing still arise from time to time and there are conflicting statements in the cases as to how the issue of standing should be assessed. Part of the difficulty inherent in this area is that there is little unanimity of view on the issue. Like many others contemporary issues in civil litigation and the adversary process, the law of standing embodies conflicting objectives and widely differing perspectives.

67. For a general discussion of this issue see de Smith, Woolf & Jowell, Judicial Review of Administrative Action (Sweet & Maxwell, London, 5th ed, 1995), chapter 2, entitled "Who May Bring Proceedings: Standing to Sue". The authors conclude at paragraph 2-103 on p 154: "The survey contained in this Chapter disclosing different tests for standing in judicial review proceedings, applications for habeas corpus on statutory applications to quash and in private law proceedings involving public law, together with the complicated provisions as to relator actions provides an overwhelming case for the need for reform of the whole issue of standing. The system needs simplifying. It is important this should happen since rules as to standing control access to justice."
Advocates of a liberal view of standing, or indeed the abolition of standing requirements altogether, argue that the existing law is so complex and confused as to serve little useful purpose. Those who argue in favour of a wider approach argue that liberalised standing requirements promote democratic objects by encouraging wider participation in the litigation process. Where it is suspected that litigation may be unmeritorious or is being used for an extraneous purpose, such as to further a party's commercial or economic objectives, there are other mechanisms available under the rules of court to control such a situation, rather than attempting to justify restrictive standing requirements.\(^68\)

Some jurisdictions, such as Canada\(^69\) and New Zealand\(^70\) have traditionally taken a more liberal view of standing in relation to public interest issues. In other common law jurisdictions a similar basic approach to standing has been taken. Under English law, the traditional test was whether the applicant had a sufficient interest in the

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\(^{68}\) For a recent example of such an argument see Fisher & Kirk, "Still Standing: An Argument for Open Standing in Australia and England" (1997) 71 Aust LJ 370.

\(^{69}\) The Supreme Court of Canada has recently set out the approach to be adopted to questions of standing when considering challenges to legislation under the Canadian Charter of Rights and Freedoms. In *Hy & Zel's Inc v Attorney-General of Ontario* (1993) 107 DLR (4th) 634 the Canadian Supreme Court set out a three-step approach in this area. First the intending plaintiff must show that there is a serious issue to be tried. Secondly, the plaintiff must show that it is directly affected by the legislation or is genuinely interested in its validity. Thirdly the plaintiff must show that court action is the only reasonable and effective way of testing the validity of the legislation.

\(^{70}\) For examples of recent New Zealand cases supporting such an approach see *Environmental Defence Society Inc v South Pacific Aluminium Ltd (No 3)* [1981] 1 NZLR 216 (in which the New Zealand Court of Appeal stated, obiter, that it would have been prepared to recognise the standing of two environmental groups to challenge the validity of an Order in Council had this been necessary); *Finnigan v NZ Rugby Football Union* [1985] 2 NZLR 159 (HC), [1985] 2 NZLR 190 (CA), (in which the New Zealand Court of Appeal was willing to recognise that two members of local rugby clubs had sufficient standing to challenge a decision of the New Zealand Rugby Football Union to tour South Africa). As the present President of the New Zealand Court of Appeal, Sir Ivor Richardson, has stated extra-curially in a recent article, "Public Interest Litigation" (1995) 3 Waikato LR 1 at 12-13: "In some jurisdictions arguments over standing can occupy much time of the courts and are a feature of its administrative law. There is an understandable concern that the court processes should not be used for the proliferation or expansion of litigation by organisations and individuals who, though well meaning, have only a marginal interest in an issue. The New Zealand courts have tended to take a broad if not relaxed view of standing and have never felt oppressed by a busybody problem...In practice, the more important question is how can the court ensure that all relevant public interest considerations are advanced and tested?"
proceedings. This view was somewhat modified in the so-called *Fleet Street Casuals* case in 1981, in which the House of Lords held that the modern approach to standing was to look at a number of inter-related questions, such as the nature of the statutory power or duty under challenge, the kind of breach alleged, the features of the individual applicant in relation to the exercise of the statutory power, and the subject matter with which the litigation was concerned.

As Craig has noted, in practice the level of analysis of the issue of standing in English cases is seldom as detailed as the application of these criteria might seem to suggest. While it now seems to be generally accepted that standing is not contingent on the applicant demonstrating a direct interest of a legal or financial nature, and also that persons with no genuine interest (the traditional "mere busybody") will not have standing, where the line is to be drawn between these two extremes is still rather unclear in English law. Indeed, it is possible to find examples of recent English cases which have adopted a comparatively restrictive view of standing in relation to public interest litigation. All of this is of course reflective of the differing perceptions among the judges as to the desirable scope of the doctrine of standing.

The topic of public interest interventions in English law has been considered by a Working Party under the chairmanship of the Honourable Mr Justice Laws and a

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71. The traditional formulation was that contained in *Boyce v Paddington Borough Council* [1903] 1 Ch 109 at 114, which focused on whether the plaintiff could establish some interference with a private right or "special damage peculiar to himself".

72. See *R v Inland Revenue Commissioners, ex parte Federation of Self-Employed and Small Businesses Limited* [1982] AC 617.

73. See Craig, *Administrative Law* (Sweet & Maxwell, London, 3rd ed, 1994) at pp 494-498. As Craig observes at pp 494-495: "There are a number of cases in which the courts have treated the IRC decision as a liberalisation of the pre-existing standing rules. However, it is also to be noted that the cases mentioned within this section do not evidence a particular attachment to the fusion technique. In reaching the decision to accord the applicant standing the courts did not undertake any detailed analysis of the nature of the statutory powers or provisions which were in question, apart from adverting to the seriousness of the alleged illegality."

74. See for example *R v Secretary of State for the Environment, ex parte Rose Theatre Trust Co* [1990] 1 QB 504; *R v Poole Borough Council, ex parte Bee Bee* [1991] 2 PLR 27. For a discussion of the recent cases see Cane, "Standing up for the Public" [1995] Public Law 276.

75. See Lord Justice Schiemann, "Interventions in public interest cases" [1996] Public Law 240.
report on the matter has recently been issued. This report concluded that special recognition should be accorded to public interest cases and in the area of judicial review there should be a broad discretion in relation to issues of standing based on public interest criteria. In relation to the question of public interest interventions, the report noted several English cases where the courts had allowed public interest intervenors to participate.

The Working Party noted the widespread use of amicus briefs in US practice and recent Canadian developments such as detailed provisions in the Ontario Rules of Civil Procedure under which intervenors were required to demonstrate to the court that they not only had a legitimate interest in the proceedings but also that their submissions could contribute usefully to the case. It also referred to the widespread use of third party interventions in cases before the European Court of Human Rights. Draft amendments to the Rules of the Supreme Court dealing with leave to intervene in judicial review proceedings were proposed. While these


77. The Working Party's conclusions are summarised at page 6 of the Report, ibid:

- "Public interest challenges should be explicitly recognised as a category of case and the High Court in judicial review proceedings should continue to have a broad discretion to allow individuals, groups and organisations to bring such cases. In making its decision, the first and most important question for the court is whether the issues raised by the prospective litigation ought in the public interest to be adjudicated upon.
- There are important advantages to be gained in the judicial process by allowing third party interventions in public interest cases where it is shown that the intervention is likely to assist the court. The court should retain strict control on who may intervene and in what manner.
- The present system of appointing a conventional amicus curiae to assist the court generally works well."


81. The draft Rule amendments would require a prospective intervenor, when seeking leave from the court to intervene in judicial review proceedings, to detail the issues in the proceedings that raise a matter of public interest, the relevance of these issues to the intervenor and the ways in which the intervenor believes its submissions would assist the court. Leave is not to
recommendations would undoubtedly liberalise the scope for participation in judicial review proceedings, they are of course restricted to the area of judicial review and would not be readily applicable to regulatory hearings generally.

The other issue raised by this debate is the role of interest groups in this process. In the United States, interest groups have long been a central feature of the political and constitutional scene, as was noted in chapter 6. The institutionalised use of interest groups has been less pronounced in British practice and there are suggestions in the academic literature that the previously predominant approach of consulting widely with interest groups has tended to decline over the past decade, although there are signs that this trend may now be reversing itself.

The English courts have been prepared to recognise that the remedy of judicial review is available both to individuals and groups, whether the latter are incorporated or not. Clearly, it may often be easier from a logistical (and financial) perspective for organisations as opposed to individuals to participate both in judicial review challenges and regulatory procedures. A recognised body may also find it easier to be granted by the court "unless it is satisfied that - (a) the proceedings raise a matter of public interest, and (b) the intervention is likely to assist the court."


83. See Grant, Pressure Groups, Politics and Democracy in Britain (Philip Allan, Hemel Hempstead, 1989); Maloney, Jordan and McLaughlin, "Interest Groups and Public Policy: The Insider/Outsider Model Revisited" (1994) 14 Jnl Publ Pol 17; Baggott, "From Confrontation to Consultation? Pressure Group Relations from Thatcher to Major" (1995) 48 Parliamentary Affairs 484.

84. The seminal case of R v Panel on Takeovers and Mergers, ex parte Datafin plc [1987] 1 All ER 564 established that the remedy of judicial review extended to unincorporated bodies such as the Takeover Panel, a body which Sir John Donaldson MR noted in his judgment (at [1987] 1 All ER 564 at 566) was an "unincorporated association without legal personality" and operated "without visible means of legal support." In jurisdictions which have a judicial review procedure based on statute, this issue is often dealt with in the legislation. In New Zealand, for example, under s.3 of the Judicature Amendment Act 1972, the judicial review jurisdiction extends to a "statutory power", the definition of which includes "a power or right...to require any person to do or refrain from doing any act or thing that, but for such requirement, he would not be required by law to do or refrain from doing." The term "person" is itself defined in s3 of the New Zealand Act as including "a corporation sole, and also a body of persons whether incorporated or not."
establish intervenor status and to obtain government support or funding for a particular initiative.85

A recent report of the Australian Law Reform Commission has recommended a significant expansion in the law of standing in public interest litigation, including a restructuring of the *amicus* system to allow intervenors to produce short briefs to assist the court in such cases. The Commission recommended that the applicable test should be based on whether the grant of standing would resolve an important question of law, thus removing the need for further litigation, and whether the issue in question affected a significant portion of the community.86

These developments in the public law arena are to be welcomed. However the remedy of judicial review is in one sense retrospective in that it can only be invoked after the relevant decision has been reached and is subsequently the subject of challenge. In order to facilitate genuine participation in regulatory processes on the part of consumers, structured mechanisms which embody not only liberal rules as to standing, but which also encourage different interest groups to play an active part, are necessary.

85. In a recent Australian example, the Australian Federal Government agreed to finance an attempt by the Consumers Federation of Australia, represented by the Public Interest Advocacy Centre, to oppose a test case in the New South Wales Court of Appeal whereby National Australia Bank was attempting to overturn a High Court decision holding the Bank liable in respect of the proceeds of forged cheques. (The Court of Appeal's decision of 17 June 1996 under the name *National Australia Bank Ltd v Hokit Pty Ltd & ors*, dismissing the appeal, can be found on the internet at web site http://www.austlii.edu.au/cases/nsw/supreme_ct/95040542.html.) Government funding was provided from funds set aside for the purpose of supporting such test cases and the court allowed the Consumers Federation of Australia to intervene as *amicus curiae*, such intervention being limited to matters of public interest not dealt with by the other parties. See article in the *Australian Financial Review*, 27 February 1996, p 5: "Fed Govt backs consumers on cheque case".

86. See *Beyond the Door-Keeper - Standing to Sue for Public Remedies* (Australian Law Reform Commission, Canberra, Australia, Report No. 78, 1996), text on the internet at web site http://charlotte.anu.edu.au/arlc/report78/ALRC78.html. The Committee's recommendations, as listed in Appendix F of the Report, (web site http://charlotte.anu.edu.au/arlc/report78/ALRC78AppF.html), include as Recommendation 4 - Intervention at the court's discretion: "A court may, at any stage of proceedings, on its own motion or upon the application of a person, give leave to that person to participate in public law proceedings subject to such terms and conditions, and with such rights, privileges and liabilities (including liability for costs), as the court determines. // When deciding whether to grant leave the court should have regard to whether the intervenor's contribution will be useful and different from those of the parties to the proceeding and whether the intervention will unreasonably interfere with the abilities of the parties having a private interest in the matter to deal with it differently."
11.4.4 Costs Awards in Favour of Intervenors

In chapter 10, the availability of costs awards in favour of intervenors in the US regulatory context was discussed. As was noted in that chapter, the jurisdiction to award costs in favour of US intervenors is limited by statute. However, while costs in favour of intervenors are sparingly awarded, the converse proposition is also true, in that costs against unsuccessful intervenors are also not awarded to the successful party, so that overall there is little disincentive to parties to participate in the regulatory process.\(^{87}\)

The position in England and most common law jurisdictions is different from this. Under the rules of procedure in these jurisdictions the court generally has a wide discretion to award costs, even against intervenors. The Working Party of the Public Law Project, in its recent report, was sceptical of whether costs should be awarded against public interest intervenors but took the view, following the precedent of the Supreme Court of Canada, that parties who were granted leave to intervene should be liable for any additional disbursements incurred by the other parties.\(^{88}\)

In other Commonwealth jurisdictions, such as New Zealand, there is jurisdiction to award costs either for or against intervenors or counsel assisting the court.\(^{89}\) In the

\(^{87}\) The ability of intervenors to participate in federal administrative proceedings has been enhanced in recent years by various forms of assistance granted by federal agents to intervenors. For a discussion of these developments see Gellhorn, "Public Participation in Administrative Proceedings" (1972) 81 Yale LJ 359; Editorial Note, "Federal Agency Assistance to Impecunious Intervenors" (1975) 88 Harv LR 1815; Office of Communication of the United Church of Christ v FCC 359 F 2d 994 (DC Cir 1966); Scenic Hudson Preservation Conference v FPC 354 F 2d 608 (2d Cir 1965), cert. denied 384 US 941 (1966).

\(^{88}\) See A Matter of Public Interest, supra note 76, p 29: "Because the function of a public interest intervener is to assist the court, we have reached the view that generally the intervener should not be vulnerable to any costs. However, looking at the Canadian experience, it would seem reasonable to give the courts a discretion. Under the rules of the Supreme Court of Canada the court, on granting leave to intervene, is entitled to order the intervener to cover additional disbursements incurred by the parties to the case as a result of the intervention. However, such an order is not made regularly against public interest interveners. We have included a similar provision in the draft new rules."

\(^{89}\) See for example Judicature Act 1908 (NZ), s 99A(1): "Costs where intervener or counsel assisting Court appear - (1) Where the Attorney-General or the Solicitor-General or any other person appears in any civil proceedings or in any proceedings on any appeal and argues any question of law or of fact arising in the proceedings, the Court may, subject to the provisions of any other Act, make such order as it thinks just - (a) as to the payment by any party to the proceedings of the costs incurred by the Attorney-General or the Solicitor-
case of the New Zealand statute, the authorities have established that the courts have a wide jurisdiction to award costs for and against intervenors under the section, although the Attorney-General and the Solicitor-General will generally bear their own costs of intervention in any particular case.90

In some jurisdictions, such as Canada, there are specific statutory powers to award costs in favour of intervenors in respect of various administrative and regulatory proceedings.91 However, even where statutory powers exist, these are sometimes exercised quite sparingly.92 A general legislative scheme was enacted in Ontario in 1988 in relation to funding of intervenors in relation to administrative proceedings involving public hearings.93

This enactment represents the first comprehensive statutory scheme in force in Canada in relation to intervenor funding and provides for prospective intervenors to apply to a state government board for approval of intervenor funding in respect of defined administrative and regulatory proceedings. Under the statute, funding is awarded where the issues in question affect the public significantly and also affect the public interest as opposed to private interests. In deciding whether funding should be awarded the board considers the interests represented by the respective


91. For a general discussion of these powers see Keeping, "Intervenors' Costs" (1989) 3 CJALP 81. For further discussion of the subject in the context of pesticide regulation see Versteeg, "Intervenor Funding: The Alachlor Review Board Experience" (1989) 3 CJALP 91.

92. See the examples discussed in Keeping, ibid, pp 82-83. The Ontario courts have held that the power to award costs does not extend to interim costs or advance funding for intervenors. See Re Ontario Energy Board (1985) 19 DLR (4th) 763. A similarly restrictive approach was taken by the Supreme Court of Canada in Bell Canada v Consumers Association of Canada (1986) 26 DLR (4th) 573.

93. The Ontario statute in question is the Intervenor Funding Project Act 1988, the provisions of which are discussed in Jeffery, "Ontario's Intervenor Funding Project Act" (1989) 3 CJALP 69.
intervenor, the intervenor's financial position and its record of participation in promoting interests of the nature in question.94

Some concerns have been expressed as to the accountability of intervenors for the use and expenditure of funding received. However generally the experience with the Ontario legislation has been considered to be a favourable one.95 The Ontario experience illustrates that it is possible to introduce workable legislative provisions for the funding of intervenors in public law litigation. Such initiatives could readily be adapted to encourage public participation in the processes of economic regulation and are to be welcomed.

11.5 Improving Consumer Representation

11.5.1 An Improved Approach to Consumer Representation

In considering an improved approach to consumer representation, some guidance can be drawn from the discussion earlier in this chapter and in preceding chapters, especially chapters 4, 7, 9 and 10, dealing with both theoretical and empirical studies of ways in this area. It is apparent from this earlier analysis that adequate representation of the consumer interest is a multi-faceted exercise. Some important aspects are as follows.

First there must be suitable mechanisms in place by which the consumer perspective can be adequately represented in the course of regulatory decision making. The analysis in part 11.2 of this chapter has served to show that one of the discernible failings of the current system of UK consumer representation in the processes of economic regulation is its comparative lack of independence. Where the regulatory authority is also charged with protection of the consumer interest then significant prospects of a conflict of interest emerge. Protection of the consumer interest may not readily be compatible with other statutory objectives, such as the promotion of

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94. See Jeffery, ibid, pp 77-78; Intervenor Funding Project Act 1988, s 7.

95. For a discussion of the practical operation of the Ontario legislation see McWilliams, "Ontario’s Intervenor Funding Project Act: The Experience of the Ontario Energy Board" (1991) 5 CJALP 203.
efficient and profitable economic activity, environmental protection, and other such goals.

Consumers may also be hindered in terms of participation in regulatory processes by lack of access to regulatory information. Although the situation has improved considerably in recent areas in relation to the privatised utilities, much information provided to regulatory bodies is still classed as commercially sensitive or confidential and access is restricted. Similarly there is little scope for participation by organised interest groups operating outside the various industry consultative committees or consumer councils.

As the discussion in this chapter and in previous chapters has shown, there are no structured hearing mechanisms in place as in the case of US utility regulation. The case studies in chapter 10 showed that the US system of state public utility regulation catered for participation in regulatory hearings by both private and state-funded consumer interest groups. It is possible to envisage that participatory mechanisms short of full adversarial hearings could be introduced into UK economic regulation. For example, the utility regulators might be required to convene a consultative forum on pricing and service issues at which interest groups could present submissions. The case study of the OLO Group in UK telecommunications, as discussed in part 9.2.2(ii) of chapter 9, provides some precedent for such a structure, although in that case the grouping was composed of industry representatives rather than consumer interests.

It might also be possible to enlist the aid of existing competition law structures so as to facilitate consumer representation. For example, consumers might be empowered to seek MMC review of a regulatory decision, or a procedure might be put in place to allow the Office of Fair Trading to more cogently reflect consumer concerns in relation to particularly regulatory decisions.

Another aspect of the exercise concerns the financial incentive for regulated entities to take account of the consumer interest. As the discussion in preceding chapters has shown, these companies have tended in the past to give undue weight to the interests of shareholders and management as opposed to consumers of their services. This has been illustrated in a number of ways, ranging from a preference for larger profits and
dividend returns at the expense of lower consumer prices, to enthusiasm for substantial executive remuneration even in the face of widespread consumer protests. A more recent example is afforded by the utilities windfall tax, the effect of which is likely to be felt by consumers as well as by shareholders.\textsuperscript{96}

Any improved regulatory regime should also provide financial incentives for companies to benefit consumers. In this context, the RPI-X system of price cap regulation appears insufficiently refined to achieve this outcome. Under the existing price cap formula, firms may be tempted to achieve de facto price increases by reducing servicing costs, thereby leading to reduced standards of customer service. A number of solutions have been suggested to this problem, including introducing sliding scale benefit sharing and factoring allowances for acceptable service standards into the price cap formula. It may also be possible to provide for specified performance targets and for the payment of financial penalties or compensation to customers in the event of poor service. Enforcement of penalties of this nature is however problematic, as recent experience in the water and rail industries has shown.\textsuperscript{97}

While the adoption of a refined price capping formula might not be the sole answer to the problem of consumer representation itself, given the propensity of the regulated firms to endeavour to circumvent regulatory restrictions, such an innovation would be a positive step. In combination with the other improvements

\textsuperscript{96} See for example, article in \textit{The Times}, 31 May 1997: "Yorkshire Water Spent £33m on Tankering", which noted: "Customers may be affected by the Government's windfall tax on privatised utilities. The company [Yorkshire Water] said: 'This certainly isn't a victimless tax'."

\textsuperscript{97} For a discussion of some of these difficulties in the context of the water industry see part 7.4.5 of chapter 7 (with particular reference to the experience of Yorkshire Water in refusing to accept licence changes allowing customers an automatic right to drought compensation) and the recent experience with Connex Rail, which has been endeavouring to escape paying compensation to passengers of up to £10m for disruption to train services between London and Brighton, Hastings and Ashford caused by union disputes over overtime payments to train drivers. See article in \textit{The Times}, 1 September 1997: "Connex Aims to Side-step Compensation".
suggested in this part of the chapter a modified RPI-X formula is to be recommended.\textsuperscript{98}

Consensual techniques which would serve to avoid or minimise some of the shortcomings in the adversarial system of litigation are also to be encouraged. The US case studies discussed in chapter 10 showed that the use of consensual settlement procedures which involve input from consumer groups have become an essential part of the US system of public utility regulation in recent years. Such procedures can also facilitate the early resolution of interconnection disputes between industry participants, thereby opening the way towards competitive trading. In this way consensual procedures, ADR and arbitration may also serve the consumer interest less directly by opening the way towards a more fully competitive market. This has been especially significant in the telecommunications sector and is also likely to be of importance in the gas and electricity industry.

Adequate means of enforcing regulatory obligations are also necessary in this context. The case study in parts 9.6 and 9.7 of chapter 9 of the OFTEL fair trading condition showed that the introduction of this condition into the licences of UK telecommunications operations has served to promote licence enforcement in the consumer interests. OFTEL has been given a broader discretion to regulate anti-competitive behaviour without the need to demonstrate a breach of a particular licence condition, a task which was often difficult under the former regulatory approach. Similarly, the recent emphasis on the part of the rail regulator on licence enforcement, as discussed in part 4.3.4 of chapter 4, is a welcome development.

\textsuperscript{98} For a concise summary of some of the deficiencies in the RPI - X approach see article by Purdy and Cullum, "Utility Regulation: A Consumer Perspective" (1997) 8 Util LR 138 at 150: "Finally, the role of RPI-X price caps pervades all discussions of the effectiveness of the current regulatory regime for the privatised utilities. Although there is generally wide agreement that price cap regulation has substantially improved the efficiency performance of the various privatised utilities, public disquiet over the high profits of these companies remains strong. Although it is possible to argue that there have been presentational failures concerning the incentive nature of price cap regulation - 'high profits today are necessary for lower prices tomorrow' - it is, nevertheless, likely that other explanations are also relevant. One possible approach might be to modify the existing RPI-X regimes to take greater account of the origin of excess utility profits. This would allow adjustment of price control formulae for the effects of purely exogenous factors such as economic growth, while leaving intact efficiency incentives related solely to the company's own internal performance."
It is instructive to relate the above discussion to the regulatory benchmarks set out in part 1.10 of chapter 1. To begin with the goal of certainty, the above proposals would advance the attainment of this objective. A more precise price capping formula would allow for greater certainty of regulatory outcome in terms of the position of consumers. If promotion of the consumer interest is seen as a desirable regulatory goal (which it is at least by this writer), then the above proposals also lend themselves to the achievement of certainty. Promoting participatory roles by interest groups, more open access to information and the independent representation of the consumer interest should all lead to a more certain outcome so far as the position of consumers is concerned.

Similarly the goal of accessibility is also furthered by the above model. The foregoing recommendations should lead to a more open and transparent regulatory regime which would encourage interest group participation by consumer representatives.

The above proposals are also relevant to the goals of effectiveness and efficiency. They would allow representatives of the consumer interest to participate effectively in regulatory proceedings. Aspects such as provision of regulatory information and enforcement of licence conditions ought to be conducive to promoting both effectiveness and efficiency in regulatory processes.

The goals of accuracy and fairness should also be promoted by the foregoing model. The proposals would tend to encourage the regulatory process to reach an optimal result so far as promotion of the consumer interest is concerned. The adoption of a more detailed price capping formula is particularly apposite here. Similarly the goal of fairness would be encouraged by encouraging wider provision of regulatory information and meaningful representation of the consumer interest in regulatory processes.

The goal of enforceability forms a central part of the above proposals. While the appropriate enforcement strategy to adopt must always be the subject of a considerable degree of regulatory discretion, it is encouraging to see bodies such as the utility and rail regulators paying close attention to this aspect of regulatory practice.
The goals of accountability and autonomy would also be served by the above proposal. The availability of review structures involving the MMC, together with more structured forms of participation in regulatory processes, would serve to improve the accountability of the regulatory system without unduly diminishing its independence and autonomy. In this way the important balance between these two goals can be maintained.

It is appropriate at this point to give some consideration to whether it is desirable in the UK context to adopt fully-fledged APA type procedures along US lines, involving both rule making and adjudication. This issue has already been the subject of some analysis in part 8.4.5 of chapter 8, in which the possible application of an APA type structure in the United Kingdom was discussed. It is possible to envisage modified procedures which incorporate the spirit of the APA initiatives without the excessive cost and complexity which is sometimes thought to accompany them.

For example, the above proposals envisage the use of consensual techniques such as mediation, ADR and consultative hearings by regulators, which could serve to overcome some of the less desirable features of the adversary process, as these have been outlined earlier. Similarly availability of information is a crucial factor in this exercise. The discussion in part 11.3.2 of this chapter of the New Zealand experience with light-handed regulation has highlighted the use of information disclosure regimes in this context.

Finally financial incentives in the form of a refined RPI-X formula together with more stringent enforcement techniques could be combined with modified APA type procedures. Despite the difficulties with the US model which have been discussed in earlier chapters, particularly chapter 6, this writer remains of the view that more extensive use of rule making powers and some form of modified adjudicative procedure, even if only on semi-formal lines, still need to be introduced into UK economic regulation. Such procedures have undeniably served to improve the position of consumers in the United States, as the case studies in chapter 10 have shown, and there is no reason why they should not do the same for UK consumers as well.
11.5.2 The Use of Arbitration, ADR and Other Consensual Techniques in Economic Regulation

Previous chapters have referred to the use of arbitration, ADR and other consensual techniques in the processes of economic regulation. In chapter 4 there was some discussion of New Zealand proposals to introduce binding arbitration techniques in relation to interconnection disputes.\(^{99}\) The interconnection agreement finally negotiated between Telecom New Zealand and its principal competitor, Clear Communications Limited, contained an extensive dispute resolution provision.\(^{100}\) This obliged the parties to negotiate in good faith in relation to matters which were subject to the agreement and in accordance with a model mediation agreement set out in Schedule H of the interconnection agreement. A copy of Schedule H is annexed as Appendix I to this chapter.

In the event that mediation was not successful in resolving the dispute within a period of three months then the dispute could be referred to arbitration in accordance with the dispute resolution clause. The clause set out a detailed procedure for the appointment of either one or three arbitrators and also prescribed detailed procedural provisions for the conduct of any such arbitration.\(^{101}\) Despite the comprehensive regime of dispute resolution embodied in the interconnection agreement, the tradition of litigation between Telecom and Clear Communications in New Zealand has been so pervasive that it was not long before the ambit of the arbitration clause itself came to be litigated in the courts!\(^{102}\)

\(^{99}\) See the discussion in part 4.6.4 of chapter 4.

\(^{100}\) See clause 38 of the Interconnection Agreement 1996 between Telecom New Zealand Limited and Clear Communications Limited dated 18 March 1996.

\(^{101}\) Ibid, clauses 38.4 to 38.16.

\(^{102}\) See Clear Communications Limited v Telecom Corporation of New Zealand Limited (unreported, High Court, Auckland, CL 54/96, Smellie J, 4 April 1997), in which the matter at issue between the parties was whether a claim for damages brought by Clear against Telecom alleging breaches of the Commerce Act 1986 and the Fair Trading Act 1986 were subject to the arbitration provisions of the Interconnection Agreement, so that the plaintiff's claim in the courts ought to be stayed. In the event the court took the view that the arbitration provisions did not extend to the plaintiff's claims, so that the plaintiff was entitled to pursue them through court action and a stay was refused.
In the United States context, as was discussed in chapter 6, the use of negotiated rule making techniques has become more popular in recent years in relation to regulatory issues.\(^{103}\) As that chapter discussed, the Negotiated Rule Making Act 1990 sets out a detailed regime in this area. Negotiated rule making has proved to be a useful technique, as was noted in chapter 6, where there are a limited number of identifiable interests and the subject matter under consideration lends itself to a negotiated outcome. This was more likely to be the case where the regulatory regime in question did not raise issues which were regarded by the parties as being ones of significant principle.

A structure which encourages precise definition of the regulatory issues involved and which provides a deadline for decision making is more likely to promote consensus among the parties involved. This is especially the case where the structure itself ensures that full information is provided to affected parties by the use of transparent processes and adequate consultation. The use of negotiated settlements in US public utility regulation provides a good illustration of these principles, as the US case studies set out in chapter 10 have illustrated.

On the other hand, issues of market structure can also be of central importance in this area. Where a regulated firm cannot foresee a significant economic advantage from contesting regulatory decisions there is likely to be greater incentive to agree to regulatory proposals. This is often the case where there is a higher degree of market competition and market power is more evenly distributed among a number of competing participants, none of which is dominant in the particular market. If, however, the cost or delay involved in contesting regulatory decisions is likely to be less than the potential economic benefit, it may be more difficult to reach agreement. The existence of adequate regulatory powers to enforce a resolution of the issue in the absence of agreement can also serve to promote consensus between the parties. These factors were well illustrated by the process of introduction of the new OFTEL fair trading condition into the licences of BT and other UK telecommunications companies, as was described in chapter 9.\(^{104}\)

\(^{103}\) See part 6.6.3 of chapter 6.

\(^{104}\) See parts 9.6 to 9.7 of chapter 9.
In other cases the structure of the regulatory regime itself may mean that it is probable the parties will be able to reach agreement on the fundamental regulatory issues involved. In cases, for example, where a franchise or licence has been awarded to carry on a particular service, it is more likely that details of the particular service can be negotiated through a consensual process. Given that the position of the regulated entity has largely been secured in terms of the award of the franchise or licence, there is considerable incentive for the regulated party to agree on matters of detail. Examples of this include the ORR procedures for the approval of track access agreements described in chapter 9.105

As well as the possibility of regulatory powers or regulatory intervention being invoked if agreement is not reached, there may also be pressure from shareholder, political or media interests to reach agreement, as the experience of the UK privatised utilities has shown. There may also be political pressure on industry regulators to achieve acceptable consensual solutions. As always, in the area of economic regulation, issues of interconnection and degree of market power often prove to be crucial determinants of the shape of the regulatory process.

While consensual techniques such as arbitration and ADR have an important part to play in the resolution of regulatory disputes, these techniques are not without their drawbacks. An evaluation of the strengths and weaknesses of such consensual techniques now follows.

11.5.3 Strengths and Weaknesses of Arbitration and ADR Techniques

To begin with the strengths of consensual techniques such as arbitration and ADR, these score highly in areas such as efficiency, expedition and ease of implementation. Mediation procedures especially can be relatively informal and the parties can be encouraged to define their areas of difference within a narrow compass and to focus intensively on these with a view to "getting to yes", to use the words of one popular

105. See part 9.3 of chapter 9.
Mediation procedures can be completed relatively quickly and their speed is often only dependent on the availability of the parties and of a suitable mediator. In the case of arbitration many of these advantages may also be present, although the prevalent use of adversarial procedures in arbitration can mean that arbitral proceedings may not be any faster than court proceedings, and may indeed be much slower.

As against these obvious advantages, there are some areas of difficulty. Some commentators have pointed to the fact that systems of consensual dispute resolution (particularly where these are mandatory in terms of their application) undermine the rule of law to the extent that it is desirable that law should consist of publicly declared standards which are known in advance and which are capable of being understood in terms of both their content and application. Procedures such as arbitration and ADR are sometimes said to offend against this principle by reason of the fact that they do not involve public scrutiny or published reasons for decision.

They may also offend against the requirement of consistency because they are tailored for individual cases and do not give rise to authoritative precedents or statements of principle, which, in the context of court-based adjudication, allow the common law to respond and develop.

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107. See for example the criticism of Devlin J (as he then was) in Peter Cassidy Ltd v Osuustukkauppa IL [1957] 1 All ER 484, in which the judge disposed of a proceeding which had been in arbitration for over three years on the basis of a short legal point which took one and three quarter hours to argue in court. As the learned judge noted at p 489: "It is, of course, beyond dispute that if business men prefer an expensive and lengthy procedure, in this case lasting something over three years, to that which this Court provides, they are entitled to have it. There are, no doubt, a great many ways in which arbitration serves a useful purpose. This, I think, is not one of them...."

108. It should be noted however that while arbitration has traditionally been regarded as a process which is confidential to the parties, recent Australian authority has raised the issue of whether there is a public interest exception which overrides this general principle. For a discussion of these developments see Rogers and Miller, "Non-Confidential Arbitration Proceedings" (1997) 71 Aust LJ 436, discussing recent Australian decisions such as *Esso Australia Resources Limited v Plozman* (1995) 183 CLR 10 and *Commonwealth v Cockatoo Dockyard Pty Limited* (1995) 36 NSWLR 662.

state of the law of negligence would be had Miss Donoghue been persuaded (or obliged) to submit her novel cause of action to mediation in 1932. It has to be suspected that the probable outcome might well have been a nominal award of damages and little, if any, precedent value for use in innumerable future cases. (In addition generations of law students would have been deprived of the picturesque vision of Miss Donoghue recoiling in horror at the sight of the decomposed snail in her ginger beer.) Many other examples come readily to mind. Lloyds Bank may have bought off the grievances of the Bundys for a nominal sum. The seminal case of Hedley Byrne may never have got near a courtroom and so on.

There may be particular problems with applying consensual/ADR techniques in the public law area. The absence of statutory authority for such procedures can cause difficulty. Even where specific legislation exists, as in the case of the Negotiated Rule Making Act in the United States, and other statutory incentives to develop ADR programs, there may still be practical difficulties of implementation. Experience with negotiated rule making in the US context has shown that the intensive participation required on the part of public interest groups may effectively serve to disqualify them from participating meaningfully in such procedures.

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110. For example, under the Administrative Dispute Resolution Act 1990, all federal agencies are required to develop ADR policies, to appoint an ADR specialist and to make available employees with specific training in ADR procedures. For a discussion of these initiatives in the US federal context see Singer, Settling Disputes: Conflict Resolution in Business, Families and the Legal System (Westview Press, Boulder, San Francisco and Oxford, 2nd ed, 1994), chapter 1 at pp 10-11; chapter 7, pp 141-142.

111. See for example Singer, ibid, p 150: "Nevertheless, participation in frequent all-day meetings in Washington is expensive. When asked what special problems reg-neg posed, Ford's Kelly Brown replied, 'Time and money. My travel budget got destroyed'. For representatives of environmental and other public interest groups, the handicaps are more serious. David Doniger, an attorney with the National Resources Defense Council, noted that participating in a reg-neg takes about ten times as much of the group's resources as commenting on a rule." For further discussion of the use of ADR methods to resolve disputes of a public interest nature see Goldberg, Sander & Rogers, Dispute Resolution: Negotiation, Mediation, and Other Processes (Little, Brown and Company, Boston, 2nd ed, 1992), chapter 8, entitled "Public Disputes". For the application of these techniques in the environmental and planning area see McDonald, "The Application of Alternative Dispute Resolution Techniques to Environmental and Planning Disputes" [1994] Env Liability 134.
Similarly, in the context of utility consumer dispute settlement, the effectiveness of dispute resolution procedures continues to be a matter of debate. Utility companies characteristically argue that such procedures allow unscrupulous customers to manipulate the system to defer disconnections without making any payment for utility services. Where arbitration procedures have been used to resolve consumer disputes with private companies the experience has been mixed.

Consumer satisfaction with low cost arbitration schemes decided on a documents-only basis has generally been less than where consumers have been able to meet with the arbitrator to make personal submissions. As always, justice is more effective when it is also seen to be done. On the other hand the advantage of arbitration on a documents-only basis is that a consumer is not likely to face a significant costs sanction after failing to succeed at a hearing before the arbitrator. However, there is little room for doubt that a structured dispute resolution model in this area tends to reduce general customer dissatisfaction and possibly also reduces consumer pressure directed against rate increases by the companies.

In the context of disputes which have a public interest element, such as those arising in the area of economic regulation, private decision making by a narrow range of interested parties may not contribute to the integrity of the system to the extent which

112. In the state of Pennsylvania for example, the Bureau of Consumer Services within the state public utility commission has power to negotiate informal settlement agreements between the parties to disputes over utility services. For a discussion of practical experience with the Pennsylvania model see Hyman, "Utility Consumer Dispute Settlement: A Regulatory Model for Mediation, Arbitration, and Class Advocacy" in Mills (ed), Conflict Resolution and Public Policy (Greenwood Press, New York, 1990), chapter 4; Silver, The Organizational Behavior of Regulatory Agencies: A Case Study of the Bureau of Consumer Services in the Pennsylvania Public Utility Commission (Pennsylvania State University, Pa, 1981).

113. For a discussion of the use of arbitration in the case of consumer disputes in industry see Consumer Redress Mechanisms: A report by the Director General of Fair Trading into systems for resolving consumer complaints (OFT publication, London, November 1991), pp 51-54. The OFT concluded at para 6.18 of its report as follows: "The OFT's 1981 report recommended that arbitration should be on a documents-only basis. This followed adverse publicity following a few cases where consumers had requested personal hearings under code arbitrations and, having been unsuccessful, found themselves liable for substantial legal costs. Almost all code arbitrations are now conducted on a documents-only basis. The NCC report Out of Court found that there was a significant demand for personal hearings among consumers, and recommended that the facility be introduced. This seems undesirable. When personal hearings were available they were rarely used. They would increase the costs and delays in arbitrations. Those who do wish to have a personal hearing have the option of using the county court where the financial limit was increased in July 1991."
is desirable. There has been considerable discussion in the American academic literature on this topic. While US writers recognise that unrestrained adversarial processes in the US mould are not necessarily desirable, on the other hand abandoning them altogether may well result in throwing the baby out with the bath water. The key issue here is the respective weight to be assigned to efficiency in achieving resolution of a given dispute as opposed to the need to develop a coherent and predictable body of law in a particular area. (To this extent the debate reflects to some extent the old chestnut of fairness versus certainty in the law.)

In Britain, similar reservations have been expressed as to the systemic effects of widespread resort to ADR processes. However, ADR procedures are making increasing inroads, in both litigation before the courts and in UK regulatory practice. In the rail context, where Railtrack plc has a licence obligation to publish arrangements for granting access to its coded computer systems, disputes arising out of its published code of practice are to be referred to a panel of arbitrators. The arbitration itself is to be conducted in accordance with the industry rules.


115. See Brown & Marriott, ADR Principles and Practice (Sweet & Maxwell, London, 1993), chapter 23, entitled "ADR Reservations".

116. See for example article in The Times, 29 October 1996, "Judges give an aye to the use of more ADR", recording that the Lord Chief Justice, Lord Bingham of Cornhill, and a number of other judges, had given public support to the use of ADR as a means of resolving commercial disputes. English judges have been prepared to accord increasing recognition in recent years to the validity of dispute resolution mechanisms not involving litigation in the courts. See for example the observations of Lord Mustill in Channel Tunnel Group Ltd & anor v Balfour Beatty Construction Ltd [1993] AC 334 at 356: "...I would endorse the powerful warnings against encroachment on the parties' agreement to have their commercial differences decided by their chosen tribunals."

117. See Code of Practice for the Management and Development of Railway Information Systems (Railtrack plc, London, March 1996), clause 21. (I am grateful to Mr Christopher Guy of the City law firm of Simmons & Simmons for making a copy of this Code of Practice available to me.)

118. Ibid clause 21.5: "The applicable provisions of the Industry Dispute Resolution Rules relating to arbitration shall apply to the procedure to be followed by the Panel of Arbitrators, subject to the following particular provisions in this Code." For the Rules themselves see The Railway Industry Dispute Resolution Rules (London, September 1995). These Rules provide
Clearly consensual/ADR processes may not be suitable for all occasions. Ground breaking points of law, matters of constitutional principle or civil rights and other disputes with a strong public interest component (including many disputes which at present come before the courts under the judicial review procedure) may well prove to be unsuitable.

In the regulatory context, consideration needs to be given to the process in question. In utility rate setting disputes, for example, where the relevant principles to be applied by a public utility commission have been clearly established through statute and long usage, there may be no harm in widespread reliance on consensual techniques such as negotiated settlements. ADR may be ideally suited to consumer-intensive processes such as rate-setting in cable TV, where speedy and efficient resolution by a neutral party is the paramount consideration.\(^{119}\) However, where the point at issue is a novel one, or concerns a new development, such as the restructuring of the US electric utilities, for example, it may be difficult to avoid a legal challenge in the courts. The case studies set out in chapter 10 provide adequate illustration of these points.

Similarly, in the UK context, where a regulatory proceeding consists largely of the regulator applying monitoring or oversight in a particular area, a consensual process may be entirely appropriate. Again, the procedure for ORR approval of track access agreements provides a case in point, as was shown in chapter 9. However, where the powers of a regulator are under challenge, or there is a need for clarification of the statutory scheme imposing a regulatory regime, court proceedings may well be inevitable. The case study in chapter 9 concerning the OFTEL fair trading condition provides an illustration of this. The same applies when there is a need for a precedent setting ruling, as for example on issues of terms of interconnection or the ability of utility companies to disconnect customers. Mediation techniques are also

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119. See Berman, "Rate Regulation: Cable TV is Ready for ADR" [1993] Arbitration Jnl 70, noting that Congress, in enacting the Cable Television Consumer Protection and Competition Act 1992, was concerned with "reducing the administrative burdens on subscribers, cable operators, franchising authorities and the Commission" and that the adoption of ADR techniques would further this objective.
proving popular in the EC regulatory context, as the discussion of EC telecommunications regulation in chapter 7 noted.\textsuperscript{120}

The lesson of these examples is that it is difficult to generalise in this area. The object and purpose which the regulatory processes seek to achieve must always be kept in mind. In some cases efficient resolution of a dispute which is significant to the parties themselves but which has limited precedent value may point towards the need for consensual procedures which emphasise efficiency and expedition. On the other hand, where there is a need to provide guidance on the meaning of legislation, or to furnish binding precedents for the assistance of future participants in the regulatory process, a determination by the courts in the normal way may be desirable, if not inevitable. Looking at the matter overall, consensual procedures in the area of economic regulation have an important role to play. However that role is complementary rather than exclusive in nature.

11.6 Summary and Conclusions

The above discussion has shown that the need for protection of the consumer interest in economic regulation is a pervasive one regardless of the form of a particular market structure. The study of the differing approaches to regulation of the regulated utility markets in Australian and New Zealand in part 11.3 above has shown that the need for intervention in the consumer interest persists where there are elements of natural monopoly in otherwise deregulated markets. In Australia, the current approach has been to transfer responsibility for regulatory oversight to a specialist competition law body backed by comprehensive statutory requirements governing areas such as interconnection. In New Zealand, on the other hand, the government's preference for light handed regulation has continued, although the results can hardly be described as universally commendable, at least from the perspective of the consumer interest.

\textsuperscript{120} See part 7.10.4 of chapter 7. The use of informal mediation and conciliation techniques in EC utilities law is also proving increasingly popular. For a survey of the use of these techniques in European law see Bonino, "Protecting the European Consumer" (1995) 6 Util LR 95.
The study of the UK model has shown that the structures that existed under nationalisation, which performed with indifferent results from a consumer protection perspective, have to some extent been perpetuated in relation to the privatised utilities and rail transport. Although the industry regulators in these areas have similar statutory responsibilities to take account of the consumer interest, the structures adopted to achieve this end have varied in nature. At one extreme, the Gas Consumers Council is an example of a largely independent regulatory body which has its own funding and which enjoys considerable autonomy from the industry regulator. At the other extreme, as for example in the water industry, the Regional Customer Service Committees are identified more closely with OFWAT and the Director General of Water Supply has a role in appointing members to these committees.

As the discussion in part 11.2.2 of the chapter showed, there are areas of strength and weakness in the UK approach. On the positive side the consumer representation bodies perform a valuable role as mediators between consumers and the utility companies and have achieved a reasonable cross sectional representation from different classes of consumers. However there are also a number of disadvantages, which in this writer's view have tended to eclipse the areas of advantage.

To begin with, the close identification of some of the consumer bodies with the industry regulators has tended to provoke disquiet about the effectiveness of such bodies in promoting the consumer interest over that of other stakeholders in the regulatory process. From a structural point of view there is also reason to doubt that the ability to lobby or provide input into regulatory decisions is an adequate means of promoting the consumer interest where there is no compulsion on the regulator to take account of the views expressed. In this area the UK model suffers greatly in comparison with the US models of public utility regulation which were described in chapter 10. While the US approach can be the subject of criticism on grounds of cost and complexity there is no doubt that it obliges the regulator to address specifically submissions from consumer protection bodies and to provide cogent reasons why these submissions are either to be adopted or disregarded.
The chapter also explored in some detail barriers to participation in adversarial processes resulting from lack of resources and difficulties with obtaining standing. Various solutions to these difficulties were canvassed, such as the use of contingency fees, procedural innovations such as case flow management and a more liberal approach to standing issues. Difficulties such as seeking consumer remedies through actions in tort, such as claims for breach of statutory duty, were also examined, along with other disincentives to intervenors, such as the possibility of adverse costs sanctions.

Part 11.5.1 of this chapter then discussed the attributes of an improved model of consumer representation. Such a model would incorporate structured participation procedures allowing for consumer interest groups to play a meaningful role in regulatory processes. It would allow for the more widespread dissemination of regulatory information, the possible ability of consumers to seek MMC review, refinements to the existing price capping formulae and more concerted enforcement efforts. Some kind of possibly semi-formal regulatory forum or hearing would also be desirable. These features reflect the regulatory benchmarks in chapter 1 and also provide an example of a modified APA type approach along the lines discussed in part 8.4.5 of chapter 8.

The model also envisages that some of the identified deficiencies with the adversarial model could be overcome by the use of arbitration, ADR and other consensual processes. These techniques also exhibit various strengths and weaknesses, as was discussed in part 11.5.2 of this chapter. However these problems are still largely outweighed by various advantages with the use of these techniques. In the regulatory context such techniques are proving increasingly popular both in Britain and in other jurisdictions such as the United States. They are particularly well suited to promoting the consumer interest in a speedy and efficient manner where effective resolution of disputes by an impartial third party is the paramount consideration, rather than issues of legal principle or the need to accord full adversarial rights to the parties.

The discussion of consensual techniques has illustrated that it is difficult to generalise in this area. Arbitration, particularly, is a process which covers a broad
spectrum. At one extreme, consumer arbitrations conducted on a documents only basis may be relatively speedy and informal. At the other end of the spectrum, a fully fledged arbitration over industry interconnection issues may be more complex and take equally as long to resolve as litigation in the courts. The same is true of other consensual processes such as mediation and negotiation. While these are generally faster and more efficient than court processes, the American experience with negotiated rule making illustrates that considerable input of time and resources can be involved in such a process. These requirements frequently stretch the resources of consumer groups, even those that are relatively well organised.

In general, the analysis in this chapter has shown that the consumer interest is best promoted by structured processes which are adequately resourced and which are sufficiently independent of the regulatory body in question to ensure that consumer input is treated in a meaningful and unbiased fashion. Where these preconditions have not been fulfilled, the effectiveness of such regimes in promoting the consumer interest has been correspondingly diminished. It was Henry Ford who remarked that the consumer was king (even though his customer's choice of colour was restricted to black). However, as Shakespeare's *Henry IV* reminds us, uneasy lies the head that wears a crown.
APPENDIX I

SCHEDULE H OF THE INTERCONNECTION AGREEMENT 1996
BETWEEN TELECOM NEW ZEALAND LIMITED AND CLEAR
COMMUNICATIONS LIMITED DATED 18 MARCH 1996

SCHEDULE H
(Clauses 38.2)

MODEL MEDIATION AGREEMENT

A. The parties hereby appoint ... ("the Mediator") to mediate in the dispute described in Appendix A and the Mediator accepts such appointment upon the following terms and conditions.

1. The parties will meet the Mediator at a time and date to be arranged.

2. Prior to the meeting the parties or their legal advisers will either at a preliminary conference or by telephone agree between themselves and with the Mediator upon:
   (i) the collation and presentation of the necessary documentation to enable the mediation to take place,
   (ii) the time and venue for the mediation, and
   (iii) other necessary administrative matters.

3. The parties warrant that they or their representatives at the mediation will have full authority to settle the dispute.

4. Prior to the mediation the parties will submit to the Mediator for his or her confidential information a short written summary of their cases including, if desired, suggested settlement proposals.

5. (i) The Mediator and the parties and all persons brought into the mediation by either party, will not seek to rely on or introduce as evidence in arbitral or judicial proceedings, whether or not the proceedings relate to this dispute:
   (a) exchanges whether oral or documentary concerning the dispute passing between any of the parties and the Mediator or between any two or more of the parties within the mediation,
   (b) views expressed or suggestions or proposals made within the mediation by the Mediator or any party in respect of a possible settlement of the dispute,
   (c) admissions made within the mediation by any party,
   (d) the fact that any party has indicated within the mediation willingness to accept any proposal for the settlement made by the Mediator or by any party,
   (e) documents brought into existence for the purpose of the mediation such as position papers, or notes made within the mediation by the Mediator or by any party.

(ii) All non-parties brought into the mediation by either party shall sign a Confidentiality Agreement in the form set out in Appendix B.

(iii) Every aspect of and communication within the mediation shall be without prejudice.
(iv) This clause in no way fetters the legitimate use in enforcement proceedings or otherwise of any written and signed settlement agreement reached in or as a result of this mediation. Any constraints on disclosure included in such settlement agreement will have effect in accordance with their terms.

6 The parties will not be bound by any comments, opinions, suggestions, statements or recommendations made by the Mediator.

7 The general procedure for the mediation will be discussed by the Mediator with the parties at the outset of the mediation. Throughout the whole course of the mediation process the Mediator will be free, at his or her own unfettered discretion, to communicate and discuss the dispute privately with any of the parties or other persons brought into the mediation by them including their legal advisers PROVIDED ALWAYS that the Mediator will preserve absolute secrecy of the content of any such communications and will not expressly or by implication convey any knowledge or impression of such content to any other party unless specifically authorised to do so.

8 The parties and the Mediator agree that no statements or comments, whether written or oral, made or used by them or their representatives during the mediation shall be relied upon to found or maintain any action for defamation, libel, slander or any related complaint, and this document may be pleaded in bar to any such action.

9 The parties jointly and severally release, discharge and indemnify the Mediator in respect of all liability of any kind whatsoever (whether involving negligence or not) which may be alleged to arise in connection with or to result from or to relate in any way to this mediation.

10 The parties jointly and severally agree to pay to the Mediator no later than 21 days after the conclusion of the mediation a fee of $[ ] (plus GST) per day (up to 8 hour) and $[ ] (plus GST) per hour for other attendances including preliminary conferences together with travelling and accommodation expenses of the Mediator (if any), and other miscellaneous mediation expenses such as room hire. Such payment will be shared equally between the parties, or in such other shares as the parties may agree, having regard to the extent of each party's interest in the dispute and involvement in the mediation.

11 Each party will pay its own costs and expenses of the mediation.

B. Each party confirms that it enters into this mediation with a commitment to attempt in good faith to negotiate towards achievement of a settlement of the dispute.

C. Each party agrees that if an agreement is reached a formal settlement agreement will be prepared and signed by the parties. The parties undertake to give effect to and implement such settlement agreement in accordance with its terms.

[Signatures and dates]

[Names Printed]

Mediator

APPENDIX A

(Briefly identify the matter in dispute)
12. TOWARDS AN IMPROVED MODEL OF ECONOMIC REGULATION IN THE UNITED KINGDOM - SOME CONCLUSIONS

12.1 The Objectives of the Thesis

This thesis has been concerned with exploring improved techniques of economic regulation and the means of achieving them. It began by outlining the objectives and justifications for economic regulation and by defining some benchmarks by which regulatory behaviour could be assessed and the methodology of conducting inquiry into these areas.

The evolution of regulatory regimes was then examined in the context of historical experience. This analysis followed the development of legal regulation of monopoly and market power and the historical underpinnings of modern public utility regulation. It also traced the evolution of legal concepts of the corporate entity, the origins of the use of independent boards as a regulatory tool, the background to public ownership of industry in the United Kingdom and the move towards privatisation during the 1980s.

The concept of public ownership as a regulatory technique was then explored in further detail. Public ownership was analysed in terms of the regulatory benchmarks which had initially been defined and various areas of difficulty were examined. These included the problem of reconciling commercial and social goals, the need for improved accountability and possible shortcomings in levels of customer service. Various solutions to these difficulties were considered, including the use of innovative forms of public ownership and other control techniques such as government shareholding and the appointment of nominee directors.

Six other techniques of economic regulation were then evaluated. These were: external regulation by agency or commission, franchising/contracting, negotiation/bargaining, taxes, subsidies and tradeable permits, use of the general competition law and self-regulation. These techniques were analysed in terms of the defined regulatory benchmarks and in the context of various case studies, such as the UK experience with passenger rail franchising, the licensing of commercial
television channels and the use of contracting techniques in local authority administration under the regime of Compulsory Competitive Tendering (CCT). This part of the analysis also looked at the New Zealand experience with light handed regulation (where reliance is primarily on the general competition law) and the possible use of arbitration mechanisms in this context as a solution to interconnection and network access disputes. Techniques of self-regulation were analysed with particular reference to the UK regime of financial services regulation. Finally the use of rules and discretion was considered in the context of economic regulation and the complementary roles of these two techniques were discussed.

The thesis then went on to develop an improved model of economic regulation, based on the central premise that regulatory intervention in the economic area only attains legitimacy where it permits competing interests in the regulatory process to be assessed and balanced following full consultation and participation by all affected parties. The limitations of existing economic theories, such as public choice theory, were analysed. The varying goals of different interest groups were outlined, along with some discussion of the ways in which these groups are advantaged or disadvantaged by existing regulatory practice.

An alternative public interest approach to regulation was next discussed, based first upon a consideration of the relationship between the public interest and democratic theory, with some attention being given to defining the public interest. An improved model of regulatory intervention was then outlined, based on a coherent legislative framework, adequate regulatory guidelines and structured mechanisms to promote genuine participation in the regulatory process. This analysis emphasised that some form of inquisitorial or adversarial procedure seemed desirable, if not inevitable, especially in relation to pricing and servicing issues, although such procedures did not need to be based exclusively on adversarial court procedures. The relationship of such a model to the regulatory benchmarks was also discussed, including the need to ensure adequate regulatory powers coupled with a sufficient degree of accountability to Parliament.

The thesis then sought to expand upon how such a theory might be developed in the UK context, with some emphasis on case studies of existing regulatory practice. The
US regulatory scene was analysed in some detail, with particular emphasis on techniques of rule making and adjudication under the US Administrative Procedure Act. Some of the difficulties with these procedures were discussed, with attention being directed to the role of judicial review in the US context and the degree of deference to agency decision making exhibited by the US courts. Consideration was given to the issue of how techniques of US regulation might be applied in the UK context.

The existing state of UK economic regulation was then examined in some detail. This included some discussion of the use of the agency model to date in the context of UK social economic regulation. The use of agency regulation was evaluated by reference to a Commonwealth example, that of AUSTEL, the body which until very recently was responsible for regulation of the Australian telecommunications industry.

The UK experience of economic regulation in a number of areas was then considered, including the privatised utilities, passenger rail transport, the deregulated local bus transport industry, civil aviation and self regulation in the financial services area. In the latter area the use of rule making by the individual self regulatory bodies was examined in some detail from both a philosophical and practical standpoint. Explanatory theories of regulatory behaviour derived from US experience were evaluated and their validity was assessed in the context of the UK regulatory scene. The relevance of UK competition law and institutions was then discussed (including the role of the OFT and the MMC). Finally the increasing EC influence on UK economic regulation was considered, with particular emphasis on areas such as the electricity and telecommunications industries and the use of directives and of mediation techniques in the EC context.

The thesis then went on to look at consultation and participation techniques in UK economic regulation. UK experience in this area was examined, with particular reference to the adoption and implementation of secondary and tertiary rules and corresponding developments in administrative law, such as the evolution of the doctrine of legitimate expectation. Legislative initiatives in this area in the state of Victoria in Australia and in the province of Quebec in Canada were then discussed,
along with the increasing popularity of Codes of Practice in the UK context. The desirability of adopting APA type procedures in UK economic regulation and the usefulness of these procedures as a means of compelling the provision of regulatory information by regulated entities were then analysed. Some areas of difficulty in applying such procedures in the UK context were considered.

This part of the analysis included some consideration of the role of judicial review in economic regulation, with particular emphasis on UK experience in the telecommunications, broadcasting and passenger rail contexts. Some possible limitations on the scope of the remedy of judicial review were examined and reference was made to US experience with the use of judicial review in the regulatory context. Mechanisms for introducing modified APA type procedures in the UK were evaluated, along with the extent to which the common law might permit the adoption of such procedures and the possible application of the European Convention on Human Rights. Finally the issue of whether a specific statutory enactment along the lines of the US APA might be desirable in the UK context was dealt with together with some discussion of the possible difficulties inherent in introducing such a procedure and some relevant issues of institutional design.

Various case studies in contemporary UK economic regulation were then discussed. This exercise began by discussing the consultation procedures which had been adopted by the UK public utility regulators, particularly by OFTEL, the rail regulator and the ITC. The hearing procedures in use by the Civil Aviation Authority were then considered. This was followed by a detailed case study of the new OFTEL fair trading licence condition, covering the background to the adoption of this licence provision, including the OFTEL public hearing on 23 November 1995. The need for such a condition and the reasons for BT's opposition to the idea were canvassed in detail. The subsequent history of the dispute and its eventual resolution were also discussed. Various issues of rule design which emerged from the OFTEL case study were analysed, including the relevance of market structure and the reasons why a dominant firm might tend to prefer a regulatory regime based on rules rather than on discretion.
Various case studies in US economic regulation, beginning with the role of the state Public Service Commissions in US public utility regulation were then presented. This included a description of contemporary developments such as the recent structural changes in the US electricity industry with the advent of "retail wheeling" and the public hearing procedures adopted by the state PUCs. Innovations such as the use of negotiated settlements and consensual procedures in public utility hearings were addressed, together with some practical aspects of consumer representation by the various state consumer protection bodies. Finally attention was focused on US federal regulation, with a study of some aspects of FCC rule making in the context of the Telecommunications Act 1996.

The thesis then went on to consider the representation of the consumer interest in economic regulation, a topic of some importance to a public interest model of regulatory intervention. The practical functioning of the UK system in this area was examined, together with some analysis of structural inadequacies in this area under nationalisation and the ways in which those deficiencies were perpetuated following privatisation. Alternative methods of encouraging participation by consumer interests in the regulatory process were evaluated. These included the remedying of existing procedural and substantive deficiencies in the adversarial process, problems associated with actions for private enforcement of regulatory obligations and difficulties associated with the doctrine of standing and the costs of intervention in the public interest. Consideration was given to the most effective way of ensuring adequate representation of the consumer interest. The use of arbitration, ADR and other consensual techniques in economic regulation as a means of encouraging consumer participation in regulatory decision making was also discussed.

Finally the existing chapter seeks to draw these various threads together, beginning with a summary of the course of this thesis and going on to compare the various regulatory techniques. The way in which the chapters illustrate and support the model of regulatory intervention advanced in the thesis is discussed. Other aspects, such as the optimal use of rules and discretion, the role of public law in this area and the use of procedures which encourage consultation and participation are also dealt with in the present chapter.
12.2 A Comparison of Regulatory Techniques

The implementation of an improved system of economic regulation is not a subject which can be considered in isolation from the various methods of implementing regulation in the economic area. The technique of public ownership was discussed in some detail in chapter 3 and six other techniques of economic regulation were discussed in chapter 4. As those chapters set out, finding the perfect technique is a somewhat illusive and indeed probably unproductive task, given that the attainment of differing regulatory objectives may require the use of some techniques rather than others in any particular context. Nevertheless it is possible to reach some tentative and admittedly general conclusions in relation to the application of the regulatory benchmarks set out in chapter 1.

The table which is included as Appendix I to this chapter seeks to illustrate how the differing regulatory techniques can be evaluated from a comparative perspective, based on the discussion in chapters 3 and 4 and the case studies contained in those two, and in subsequent, chapters. As the table illustrates, it is conceptually difficult to analyse these issues in the abstract, without reference to a particular legislative framework and the accompanying rules and guidelines adopted by a regulatory body. A public enterprise which operates under well defined legislative goals and guidelines and which is managed by competent and efficient staff may prove to be an effective tool of economic regulation. On the other hand a regulatory agency which attempts to operate under a poorly drafted and vaguely defined legislative mandate, which is badly resourced and funded and where the staff lack direction, motivation or even an acceptable level of competence, may be comparatively ineffective. In general, however, the discussion in chapter 4 illustrated that, properly implemented, the agency model offers considerable scope as a vehicle of efficient economic regulation and as a structure which arguably tends to promote specialist staff expertise.

Great diversity of experience can also be found within each individual category. In the context of industry self regulation, for example, the regime of financial services regulation has worked tolerably well in the UK context (although evidently not well enough to stave off recent political initiatives aimed at increasing the level of
external government regulation in this area). However in other areas, such as press self-regulation, the experience has been less satisfactory, as the discussion in chapter 4 showed.

Similarly, in relation to regulatory regimes which rely on the general competition law, experience has also been mixed. The New Zealand regime of light handed regulation in areas such as telecommunications can hardly be described as having been universally satisfactory, as the discussion in chapters 4 and 11 showed. However the recently introduced Australian regime, based on the ACCC as the general competition law body, but with a clearer legislative mandate and with greater powers in relation to issues of interconnection, so far appears to be working comparatively well. These examples illustrate that issues of legislative design and regulatory enforceability are all-important in this area.

What does clearly emerge from the analysis in this thesis is that improved economic regulation is not a process which happens spontaneously. On the contrary it requires careful forethought, both in terms of the legislative and institutional framework, together with adequate powers of enforcement coupled with a willingness to use them. The case study of the recent introduction of the OFTEL fair trading condition into the licences of UK telecommunication operators, which was discussed in chapter 9, showed that in the UK context it is possible to design and implement regulatory measures which include an effective mix of rules and discretion. In the OFTEL case this was achieved by vesting general discretionary powers in the regulators but qualifying these with comprehensive guidelines developed in consultation with the industry, coupled with the use of advisory committees to provide input to the Director-General on regulatory decisions.

12.3 Rules and Discretion - A Regulatory Spectrum

The discussion of rules and discretion in chapter 4 showed, from a theoretical perspective, the differing characteristics of these two techniques. This point was developed further in the case studies in subsequent chapters, especially the OFTEL case study of the fair trading licence condition which was contained in chapter 9. As
the discussion in preceding chapters of the thesis has shown, a well designed regulatory regime needs to consist of an optimal combination of rules and discretion. A regime which is solely rule-based may tend towards inflexibility and rigidity of operation. It also runs the risk of being readily evaded by firms which are well advised and resourced and are able to structure their commercial activities so as to "fall between the cracks" which are inevitable in any rule-based regime. A regime based on the application of rules may also involve disproportionate input in terms of regulatory resources. The need for detailed monitoring of rule observance, together with the investigation of possibly numerous complaints of rule breaches, both trivial and serious, can impose significant administrative costs and burdens on a regulatory agency.

On the other hand, a regime which is based solely on regulatory discretion can also exhibit undesirable features. Such a regime may tend to invest the regulator with disproportionate powers in respect of the industry under regulation. It can encourage the development of a situation where powerful regulatory officials consider themselves to be beyond review either by the legislature or the courts, and indeed such a situation may in fact represent the position in practice to a greater or lesser extent. If legislation confers a wide discretion on regulatory bodies then the scope for successful challenges to regulatory decisions by way of judicial review alleging irrational or unreasonable behaviour may be limited. A regulator may be tempted to impose his or her own view of desirable industry practice on unwilling parties.

Optimality in this area can be achieved by a well designed combination of rules and discretion. Rules may incorporate some element of discretion, or general discretions may be limited by policy guidelines and statements, as in the case of the OFTEL fair trading condition discussed in chapter 9. The important point here is that designers of regulatory regimes must be responsive to the need for care in this area. The optimal combination of rules and discretion will of course vary depending upon the particular industry context. A market which is heavily dominated by a single firm which is prepared to devote considerable resources to circumventing a rule-based system of regulation may be more adequately regulated by a regime with a higher discretionary element. However where the predominant need is to ensure that regulators proceed on a consistent basis and define the parameters of regulatory
policy more precisely, a regulatory system which tends to rely more heavily on the use of rules could prove to be more effective.

These considerations may be illustrated diagramatically in terms of a regulatory spectrum in which rules and discretion are at opposite extremes and an optimal combination of these two techniques lies somewhere in between. Such a depiction of the interaction between rules and discretion is contained in the regulatory spectrum set out in Appendix II of this chapter. The individual characteristics of rules and discretion used in this Appendix have been drawn from the theoretical discussion in chapter 4 and from the various case studies in other chapters, particularly the OFTEL case study in chapter 9. As always in this area, it is difficult to generalise in advance as to the optimal combination of rules and discretion in any particular context. However it is possible to identify in general terms those factors which tend to favour a regulatory regime based more heavily on rules as opposed to discretion and vice-versa.

12.4 Achieving Improved Economic Regulation

The basic structure of the improved theory of economic regulation contended for in this thesis is illustrated diagramatically in Appendix III to this chapter. As the representation shows, the goal of improved economic regulation is based on three general premises, the need for adequate consultation in regulatory policy making, the need for adequate participation in regulatory decision making and the need for effective institutional design.

These three bulwarks of an improved model depend in turn on a number of subsidiary factors. Consultation at the policy making stage consists of the opportunity of making meaningful submissions on matters such as the design of a regulatory framework (including the optimal combination of rules and discretion in a particularly regulatory regime) together with the opportunity to have meaningful input into the setting of rules or guidelines. The discussion in the preceding chapters has shown that mechanisms for achieving this goal differ in various jurisdictions. The discussion in chapters 6 and 10, in particular, illustrated that in the US context
consultation occurs in a relatively formal and structured fashion at both the state and federal level. Standardised procedures are laid down in the federal and state Administrative Procedure Acts and the remedy of judicial review is available if the prescribed "notice and comment" procedures are not followed or if the rules eventually made are thought to exceed the agency's legislative mandate. In the UK context consultation with regulated interests has occurred with increasing frequency in recent years, though still at the discretion of individual regulators rather than pursuant to any statutory framework. The discussion in chapter 7 of UK economic regulation in various areas has shown that much progress has been made in this area. Similarly the case studies discussed in chapter 9 have revealed that regulators are increasingly aware of the importance of greater transparency in the regulatory process.

So far as participation in regulatory decision making is concerned, the discussion in the preceding chapters has shown that the US model tends towards the use of relatively formal and structured procedures, often in the context of public hearings of an adversarial nature, although in recent years this regime has increasingly given way to negotiated settlements and the use of consensual procedures such as mediation. In the UK, participation in the process of regulatory decision making is still largely informal in nature and consists of making submissions to the regulator, to which he or she may or may not have regard. The US system arguably suffers from excessive cost and complexity in some areas but nevertheless it does provide an effective means of testing the accuracy of regulatory information and also provides a structured framework within which the consumer interest and the interests of other third parties can be adequately represented. The major strength of the US system is that it provides state funding and resources for consumer representation and incorporates liberal rules of standing which ensure that interested parties are able to present their point of view to regulatory commissions.

The increasing emphasis in US regulation in recent years on negotiated settlements, often pursued in accordance with formal settlement guidelines and procedures, has meant that some of the more obvious disadvantages of fully fledged adversarial processes can be mitigated. Nevertheless, adversarial procedures can be invoked if necessary to compel adequate disclosure of information by regulated firms and to
allow for the testing of that information through discovery and cross examination. Structured processes of the US kind also ensure that the decision making body is obliged to explain why it has not adopted particular submissions by an interested party, such as a consumer organisation. Even where regulatory proceedings are settled prior to hearing, the need to convince a regulatory commission of the fairness and adequacy of the settlement itself acts as a check on the ability of regulated entities to subvert or commandeer the process. As the discussion in chapter 5 showed, adversarial procedures, despite their faults, are still an effective means of testing the accuracy of regulatory information.

Under the UK system, by way of contrast, representation of the consumer interest takes place in a more ad hoc and unstructured fashion. While some consumer bodies, such as the Gas Consumers Council, are well organised and resourced, the same is not universally true for similar bodies operating in other industries. As the discussion in chapter 11 showed, these other consumer bodies often suffer from a lack of funding and resources and their independence from the regulatory body itself may be subject to doubt, especially where the industry regulator exercises powers of appointment in relation to their membership. Furthermore the regulator is not obliged to take submissions by consumer organisations into account, or even to provide details of why the regulator has not chosen to adopt any particular submission or recommendation from such a body. The result of such a process has been widespread customer discontent in various industries, particularly water and electricity. This has been manifested in protests about exorbitant levels of executive pay in those industries and in relation to the absence of reasonable standards of customer service.

The issue of effective institutional design is closely related to these considerations. The discussion in the preceding chapters has canvassed the issue of regulatory discretion and limited accountability to Parliament. The question of whether a substantial part of UK economic regulation should continue to be exercised by single individuals in various industries, rather than by a regulatory commission, has been the subject of considerable debate, although the practical differences between these two structures may not be all that pronounced.
In the UK there is the additional issue of whether adequate competition law powers exist to address issues of market dominance and network access. This issue has been discussed at some length in chapter 7, especially in the context of the EC regime in this area and the sanctions in Articles 85 and 86 of the EC treaty. The experience with the deregulation of local bus transport in the UK discussed in chapter 7 has shown that anti-competitive conduct can still occur in a deregulated industry in the absence of adequate competition law sanctions, such as those contained in Articles 85 and 86. The need for clear legislative mandates in this area, not only on an individual industry basis, but also on a sectoral basis, has also been referred to. Finally issues of institutional design need to take into account the increasing need for harmonisation of UK and EC requirements. The influence of the third package of EC regulations on civil aviation regulation in the UK was discussed in some detail in chapters 7 and 9. EC requirements have also come to exert increasing influence in areas such as the telecommunications and electricity industries and the now foreseeable harmonisation of UK and EC competition law.

Underpinning these considerations are three areas of elephantine importance, to adopt the metaphor readily derived from the representation in Appendix III. First there is a need for adequate legislative powers to compel disclosure of information to the regulatory bodies. The British system suffers in this area from the absence of freedom of information legislation, which is taken for granted in the United States and in most other Commonwealth jurisdictions. Many legislative provisions in UK economic regulation do require such disclosure, but this in turn leads on to the issue of whether an adequate procedural framework is in place under which the accuracy and completeness of such information can be assessed. Again the debate here reverts to the need for structured processes, possibly incorporating features of an adversarial nature, in which regulatory information can be adequately assessed, with the assistance of expert testimony and input if necessary.

The second general need is for adequate public law powers, especially in the area of judicial review and possibly also the availability of public law damages. The discussion in chapter 11 has highlighted the difficulty of enforcing regulatory obligations by actions in tort, such as a claim based on breach of statutory duty. The obstacles here are both substantive and procedural in nature, as the discussion in that
chapter showed. Some of the procedural obstacles might be overcome by suitable modifications to the adversarial system in areas such as standing, costs and the scope of public interest intervention, but this still leaves the problems of substantive access to a remedy in the courts.

So far as the supervisory remedy of judicial review is concerned, the discussion in chapters 6, 7 and 8 has served to highlight some areas of interest here. The use of judicial review in a federal jurisdiction such as the United States, which has a written constitution and standardised administrative procedure requirements, may be thought to incorporate some elements of excess. However the courts in both the US and UK do tend to display a reasonable degree of deference to regulatory decisions in general. In both jurisdictions judicial review seems to be moving from the procedural into the substantive.

The US case studies in chapter 10 showed that the availability of a wide ranging remedy of judicial review exercised a salutary effect on the decision making procedures and internal organisation of regulatory agencies such as the FCC. As that chapter illustrated, such agencies quickly discovered that their exposure to possible judicial review in the courts could be reduced by ensuring internal consistency of procedure and by monitoring adherence to agency rules and procedures to promote uniformity of application. As noted above, the US courts have frequently been prepared to extend reasonable deference to regulatory decisions, albeit with some notable exceptions.

Ideally a system of public law and judicial review should encourage rationality of decision making and adherence to fair and transparent procedures. In this way, public law fulfils the important function of ensuring accountability of regulatory bodies to their own legislation and thereby to Parliament itself. The absence of formalised statutory provisions in the UK in relation to consultation and participation in regulatory decision making coupled with the broad discretions vested in regulators means that the scope of judicial review in these areas is necessarily limited. While there is still some progress to be made, the analysis of judicial review cases in the regulatory context in chapters 7 and 11 nevertheless showed that the remedy is becoming increasingly popular and is continuing to evolve.
Finally the issue of parliamentary accountability is one which should not be overlooked. In an age of increasing cynicism about the pervasiveness of bureaucracy in western countries, coupled with the increasing dilution of ministerial responsibility through the devolution of administrative power and public service responsibilities to separate agencies, the issue of accountability remains of great importance. The first step in the chain of accountability is obviously to ensure a clear legislative mandate to the agencies and clear lines of communication and parliamentary oversight.

It is in the latter area, especially, that UK economic regulation can justifiably be the subject of criticism. While regulatory independence is to be welcomed up to a certain extent, this should not be at the expense of a total or almost total lack of parliamentary accountability. Even in the US context, where the so-called independent regulatory commissions are thought to enjoy considerable autonomy of operation, their scope of action is not unrestricted. As the discussion in chapter 6 showed, they are constrained by a complex web of circumstances, including the relationship between the President and Congress, the need to obtain continued Congressional funding and support and ever-present scrutiny by the media and interest groups.

While some of these factors are present in the UK scene, they have not been developed to the same extent. Bodies such as the National Audit Office have made a valuable contribution by evaluating progress in this area, as have a number of Parliamentary select committees, many of whose reports have been referred to in the preceding chapters. The Department of Trade and Industry is at present reviewing the UK experience with public utility regulation, as was noted in part 7.4.6(iii) to chapter 7, and it will be of interest to see whether its recommendations extend to improving channels of accountability to Parliament.

12.5 The Need for a Structured Approach

One of the essential underlying features of the improved model of economic regulation advocated in this thesis has been the need for a structured framework in which the interests of different participants in the regulatory process can be assessed
and balanced against each other. The discussion of US economic regulation in chapter 10 has shown that it is possible to develop such a framework providing adequate funding and resources are devoted to the task and sufficient consideration is given to issues of institutional design. Under the US system, the public/consumer interest is represented by a system of state consumer protection bodies, as well as by private consumer interest groups. These can provide input into regulatory hearings and also into negotiated settlements. Such groups can also take part in processes such as negotiated rule making under the US Negotiated Rule Making Act 1990, as was noted in chapters 6 and 10. Bodies such as the New York State Consumer Protection Board have been prepared to adopt quite a proactive stance in relation to ascertaining consumer opinion on issues such as electricity industry restructuring, as the discussion in chapter 10 showed, and such initiatives are to be commended. The combination of the use of rule making and adjudication techniques at the state and federal level provides a range of processes which third party interest groups such as consumers can avail themselves of.

The practical application of these concepts in the UK context involves more complex considerations. The UK regulatory tradition has generally been directed towards less formal modes of participation, in which the regulatory body has considerable discretion to determine a particular regulatory outcome. The discussion in previous chapters, especially chapter 7, suggested that such a process has not always been conducive to promotion of the consumer interest, a fact which customers of the utility companies have increasingly come to appreciate in recent years. There may well be scope for introducing modified participation requirements into processes of regulatory decision making without necessarily requiring fully fledged adversarial hearings or procedures.

Increased use of consensual processes such as arbitration or mediation could be employed to oblige regulators to convene a "mini-hearing" or relatively informal mediation processes to explore points of view from all interested parties. The OFTEL public hearing initiative in November 1995 concerning the introduction of a fair trading licence condition, is a useful example of the versatility of such techniques. If similar abbreviated or semi-formal procedures could be adapted for
use in areas such as setting of price levels, then justice might not only be done but might also be seen to be done, which can often be equally as important.

In the area of rule making, the increased transparency of UK economic regulation in recent years has gone some way to compensate for the absence of a formal notice and comment procedures along US lines. However, the existing procedures are voluntary, rather than compulsory, and the absence of legislative compulsion may mean that if times and fashions should change in the future, a later generation of regulators may not feel subject to the same obligations of transparency (or may not be endowed with the same resources to implement adequate consultation procedures).

The discussion of consultation and participation requirements in UK economic regulation in chapter 8 has shown that it is possible to make improvements in this area, even outside the US constitutional framework. The legislative experience in the state of Victoria in Australia and in the province of Quebec in Canada has shown that consultation requirements in relation to secondary and tertiary rule making can be implemented in Commonwealth jurisdictions without written constitutions. Public law initiatives, such as the evolving doctrine of legitimate expectation, can also assist in this area, although the doctrine itself has limitations when in terms of its ability to enhance third party participation in many processes. Nevertheless, the general experience with the use of common law procedures to encourage such requirements has not been particularly encouraging, either in the UK or in Commonwealth jurisdictions. While there might be scope for increased reliance on Article 6 of the European Convention on Human Rights in this area, the jurisprudence of the European Court of Human Rights itself has similarly not progressed to the stage where Article 6 can effectively be invoked in these circumstances.

The fact that the design and implementation of improved procedures of economic regulation is a difficult exercise does not mean that it should not be attempted. As with all of our legal and political institutions, improvement tends to come about at the instigation of those who are unwilling to accept the status quo but who rather strive to achieve a better system. The processes of economic regulation are no exception here. This thesis does not purport to offer all the answers to many of these
difficult issues. However hopefully it will constitute a meaningful contribution to the debate.
## APPENDIX I - COMPARATIVE EVALUATION OF REGULATORY TECHNIQUES

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<tr>
<th>Regulatory Type</th>
<th>Certainty</th>
<th>Accessibility</th>
<th>Effectiveness</th>
<th>Efficiency</th>
<th>Accuracy</th>
<th>Fairness</th>
<th>Enforceability</th>
<th>Accountability</th>
<th>Autonomy</th>
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<tr>
<td><strong>Public Ownership</strong></td>
<td>Problem of secrecy, which may be addressed by the use of innovative forms of public ownership.</td>
<td>Depends upon powers conferred and structures used.</td>
<td>Traditionally regarded as less efficient than private ownership but the comparison may be flawed.</td>
<td>Possible conflict between goals to be attained.</td>
<td>Interests of consumers may be subordinated. Balance between conflicting goals not always clear.</td>
<td>Depends on the legislative framework.</td>
<td>Lines of accountability may be blurred.</td>
<td>Possibility of overt or covert government direction.</td>
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<td><strong>External Regulation by Agency or Commission</strong></td>
<td>Requires well defined legislative mandate and sufficiently specific rules or guidelines.</td>
<td>Scope for fulfilment of this goal through adequate consultation and participation in regulatory policy making.</td>
<td>Can be achieved through use of specialist expertise and well designed procedures.</td>
<td>Agency/Commission structure may be well suited to balancing different stakeholder interests through use of structured procedures.</td>
<td>Can employ a range of enforcement techniques embodying an optimal use of rules and discretion.</td>
<td>Possible problems of accountability arising from broad discretion and little formal Parliamentary oversight.</td>
<td>May be highly autonomous though subject to funding constraints and indirect controls, including media scrutiny and public perception.</td>
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<td><strong>Franchising/Contracting</strong></td>
<td>Basic levels of pricing and service can be set but fulfilment of regulatory goals not necessarily guaranteed.</td>
<td>Depends upon the transparency of the franchising/contracting process and opportunities for public participation and input.</td>
<td>Can vary greatly depending upon the precision of the conditions of award and the intensity of any regulatory regime.</td>
<td>Requires attention to the design of the applicable conditions and adequate consultation/participation.</td>
<td>Requires a flexible range of regulatory responses, not just a 'doomsday' scenario of licence or franchise revocation.</td>
<td>Depends upon the statutory framework and the relationship between franchisee and regulator.</td>
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<td><strong>Negotiation/Bargaining</strong></td>
<td>Inherently uncertain as to outcome, depending upon factors such as relative bargaining strength, negotiating ability and commitment of the parties.</td>
<td>Limited scope for public/third party participation unless desired by the parties.</td>
<td>Largely dictated by the parties themselves, with degree of fulfilment of these goals being dependent upon individual bargaining power.</td>
<td>Depends upon the sanctions available and willingness of the parties to employ them.</td>
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<td>As these are essentially party-centred processes limited scope for fulfilment of these goals.</td>
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<td>Regulatory Type</td>
<td>Certainty</td>
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<td>Taxes, Subsidies, Tradable Permits</td>
<td>Highly certain in terms of projected impact, but intended goals may not be realised in practice.</td>
<td>Taxes and subsidies attract known financial consequences. Tradable permits require well-informed and functional market.</td>
<td>May be scope for avoidance or evasion and also possibility of difficulties of implementation.</td>
<td>Depend upon the design of the taxing, subsidy or permit regime and the incentives to avoid their operation. Taxes and subsidies may be poorly implemented and inflexible. Possibility of permit schemes being abused by 'permit-hoarding'.</td>
<td>Can be backed by coercive state action but adequate resources need to be devoted to enforcement.</td>
<td>Usually implemented by a clear, legislative mandate often without the need for an external regulator, except in relation to permit schemes.</td>
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<td>General Competition Law</td>
<td>Goal of achieving a competitive market set out in legislation but may be more difficult to achieve in practice.</td>
<td>May be limited scope for third party involvement in disputes between competition law body and individual companies.</td>
<td>Depends on the legislative framework. The New Zealand experience gives cause for disquiet.</td>
<td>If recourse to protracted litigation in the courts is necessary such a regime may be demonstrably inefficient.</td>
<td>Depends on availability of adequate processes for resolving disputes by a tribunal with sufficient specialist expertise.</td>
<td>General competition law bodies may lack 'teeth' and be subject to political pressures.</td>
<td>May be limited accountability on the part of an independent, competition law body with considerable individual autonomy.</td>
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<td>Self-regulation</td>
<td>Depends on the legislative mandate and accompanying rules and guidelines.</td>
<td>Scope for use of consultation/participation techniques, though representation of the public interest may be limited.</td>
<td>Some self-regulatory regimes may suffer from complexity and obscurity e.g. overlapping tiered regulatory jurisdiction in UK financial services regulation.</td>
<td>Possible bias in favour of interests of regulated firms at the expense of public interest or the interests of investors/consumers.</td>
<td>Depends on available statutory powers and the willingness of regulators to use them.</td>
<td>Possibility of 'closed' regulation which is protective of members' interests, especially where there is an absence of procedures facilitating state oversight or monitoring.</td>
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APPENDIX II - RULES AND DISCRETION. A REGULATORY SPECTRUM

Act as a check on excessive discretion. Accord with the rule of law as obligations are defined in advance.

Scope for public law challenges (based on irrationality for example) may be more limited.

Parameters of regulatory policy may be more precisely defined, promoting certainty of operation.

May promote the development of a consistent body of precedent.

Optimality achieved by:

- well designed combination of rules and discretion
- rules incorporating discretionary provisions
- or discretion limited by policy guidelines

Counters evasive or anti-competitive behaviour by dominant firms.

Minimises problem of undesirable conduct which “falls between the cracks” e.g. rationale for OFTEL fair trading condition.

Allows for flexibility of application in novel or complex situations.

Enables individual circumstances to be taken into account.

May encourage less intrusive regulatory behaviour in developing areas e.g. telecommunications.
APPENDIX III - ACHIEVING IMPROVED ECONOMIC REGULATION
A STRUCTURAL REPRESENTATION

IMPROVED ECONOMIC REGULATION

ADEQUATE CONSULTATION IN REGULATORY POLICY-MAKING

PARTICIPATION IN REGULATORY DECISION-MAKING

EFFECTIVE INSTITUTIONAL DESIGN

Mechanism for Setting of Rules or Guidelines to Control Exercise of Discretionary Power and Establish Policy

Flexible Combination of Rules and Discretion

Means of Testing Accuracy of Regulatory Information

Structured Framework with Adequate Funding and Resources and Liberal Rules of Standing

Use of Innovative Procedures eg Negotiation, Arbitration, Mediation

Harmonisation of UK and EC Requirements

Clear Legislative Mandates - Sector Co-ordination

Company Law Innovations eg use of nominee or independent directors to represent public interest

Adequate Legislative Power to Compel Disclosure of Information to Regulators

Adequate Public Law Powers eg Judicial Review, Availability of Damages

Adequate Accountability to Parliament

Adequate Competition Law Powers to Address Issues of Market Dominance and Network Access
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