



# Principles for economic regulation

Response to the Department for Business, Innovation  
and Skills' call for evidence

18 February 2011



# Contents

Section		Page
1	Introduction	1
2	Responses to consultation questions	4

  

Annex		Page
1	Glossary of abbreviations	10

## Section 1

# Introduction

- 1.1 Ofcom is the independent regulator and competition authority for the UK communications industries, with responsibilities across television, radio, telecommunications and wireless communications services.
- 1.2 We welcome the Government's commitment to securing a system of good economic regulation that encourages investment and allows the economy to grow, as set out in the Department for Business, Innovation and Skills' (BIS) call for evidence on principles for economic regulation.<sup>1</sup> We believe the Better Regulation Executive and Infrastructure UK have identified valuable principles that will help us reach this shared goal. In particular, we welcome the wish to have clarity on the operation of economic regulation. This is the key to ensuring the sustainability of industries where long-term investment is necessary to provide citizens and consumers with high-quality services.

## What does good economic regulation look like?

- 1.3 Effective competition is the best means for developing a market that encourages investment and provides the best outcome for consumers. However, in some industries, there is enduring monopoly power in some parts of the value chain. It is necessary in these circumstances to regulate the dominant firm to promote competition where it is sustainable and protect consumers where it is not.
- 1.4 As the call for evidence recognises, the regulated sectors require high levels of investment in long-lived, sunk assets. We welcome the recognition of the importance of such investment to the UK's growth and international competitiveness. In this context, good economic regulation will promote efficient and stable markets. It will balance short- and long-term considerations and recognise the key role played by long-term investment in securing good outcomes for consumers.
- 1.5 Investors need to know the environment in which they are operating will not change radically. The market itself may develop and change, but the framework in which investment decisions are made should not. The boundaries and rules of the market must be clear, and investors must be able to anticipate whether there might be change, what might cause it and where it might come from: a regulator, the Government or the European Union (EU). Uncertainty over the source and timing of decisions increases the risk of investing, a cost ultimately borne by consumers in terms of less choice and/or higher prices.

## What is the role of the regulator in securing good economic regulation?

- 1.6 As set out above, the stability of the environment in which investment is to be made is of great importance. However, in fast changing industries such as those in the communications sector, the importance of certainty has to be balanced with a need for flexibility in responding to market and technological developments.

---

<sup>1</sup> BIS, *Principles for Economic Regulation – call for evidence*, January 2011  
<http://bis.gov.uk/Consultations/principles-for-economic-regulation-call-for-evidence>.

- 1.7 Given the need for this flexibility, it is neither possible nor desirable for a regulator to bind itself to decisions and approaches forever. But given the importance of stability to long-term investment, the regulator must provide some certainty about its approach to issues involving the recovery of sunk costs. This balance can be achieved if the regulator shows consistency in its decision-making (i.e. it should demonstrate it makes decisions on the basis of a set of principles consistent over time). Furthermore, the regulator should avoid unnecessary or unfocused intervention. When intervention is required, it should be focused on a specific problem in the market.

## **How can the Government and regulators work together to achieve this?**

- 1.8 The Government and regulators can work together to achieve the best possible form of economic regulation by providing clarity about the division of responsibilities, in particular which body will make which decision and when. This allocation of responsibilities can come in many forms (e.g. legislation, memoranda of understanding and public-policy priorities), but once the boundaries have been set and responsibilities allocated, the market must have confidence they will not change unexpectedly.
- 1.9 Where there are shared issues, regulators should work together to share best practice. This currently happens through arrangements, both formal (e.g. the Joint Regulators Group—JRG<sup>2</sup>) and informal, and there have been clear benefits from these interactions. There may be ways in which the existing mechanisms for sharing information and expertise can be further developed.
- 1.10 However, good economic regulation requires regulators to respond to their specific markets, so consistency across sectors should not come at the expense of a regulator's ability to take a long-term view of one of those sectors. It could be destabilising if investors had the impression external bodies, beyond the operation of appeals processes, could overturn or alter the decisions of a regulator.

## **Better regulation in the communications sector**

- 1.11 The most important development in regulating the communications sector in recent years demonstrated the value of our having concurrent powers under the Enterprise Act 2002 and the freedom to develop new regulatory approaches in our area of responsibility.
- 1.12 In 2004, we launched our Telecommunications Strategic Review (TSR). This brought in a new approach to the regulation of the fixed telecoms market, driving drive down costs for consumers and supporting innovation through the growth of competitive products. In light of the TSR, and in lieu of a reference to the Competition Commission under the Enterprise Act, BT agreed to give other companies access to its network, products and services on the same terms as its own retail arm (equivalence of inputs) and to provide access services to its rivals through a new, separate, ring-fenced subsidiary. The success of this new form of regulation can be gauged by the fact the number of unbundled lines passed seven million in September 2010, while 78% of homes had choice and competition in their area at the start of 2011.

---

<sup>2</sup> Ofcom, *Joint Regulators Group*, <http://www.ofcom.org.uk/about/organisations-we-work-with/joint-regulators-group/>

- 1.13 Unshackling businesses from regulations that are past their sell-by date, promoting investment and improving choice for consumers, is one of our core principles, toward which we have worked since we were established. This has brought innovation and growth to the communications sector.
- 1.14 In September 2009, we were able to remove one of the last pieces of retail regulation in the fixed-line telephone market. This came some 25 years after BT was privatised and was taken after we judged it no longer to have significant market power in the majority of retail landline markets. One of the signs of this was the emergence of other providers such as TalkTalk, Virgin Media and Sky to provide effective competition to BT and deliver lower retail prices for customers. This piece of deregulation allowed BT to offer discounted bundles of services for the first time, with new packages announced in March 2010.
- 1.15 Superfast broadband is now becoming a reality in the UK, bringing with it the potential to change how we live and work. The Government recognises this and wants to see every home in the UK with access by 2015. For investors to respond to this challenge it is important they feel confident about the future regulatory environment.
- 1.16 To ensure this, we have set out regulatory principles covering wholesale access to new fibre lines laid by BT and access to infrastructure such as the underground ducts and telegraph poles that carry cables. This will allow companies to invest directly in superfast-broadband technology. Today, Virgin Media has completed its upgrade to offer these services over its cable network. BT has also recently launched its Infinity product based on ongoing upgrades to its copper access network and has announced its intention to deploy fibre to the home. This will offer fast speeds to up to 10% of UK homes, with the possibility of extending this more widely in the future.

## Ofcom and the principles

- 1.17 Investment requires stability and we welcome the proposed principles as a mechanism for ensuring the risks of change are balanced against potential benefits.
- 1.18 Regulation in the communications sector faces a number of challenges in the coming years. These include new legislation, budget reductions and the ever increasing pace of change. In this dynamic environment, the regulatory regime should not present additional uncertainties. The principles proposed by the Government, complementing our own principles for better regulation, will inform our efforts to create this stable environment for investment, growth and innovation.
- 1.19 In responding to individual consultation questions, we set out the ways in which applying the principles could help to ensure healthy, competitive markets that encourage innovation and long-term investment to the benefit of citizens and consumers. Where appropriate, we describe the current system and how it reflects the principles. We also comment on a few areas where we would urge caution, specifically around the frequency of reviews, which could cause instability, and cross-sector working, which should not deny regulators the flexibility to take the measures best for their sectors.

## Section 2

# Responses to consultation questions

## The principles themselves

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

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

- 2.1 We believe the principles are right and reflect the areas that must be considered to secure good economic regulation that encourages investment and growth. We agree having principles to underpin the regulatory regime can be helpful and finding ways to apply them will provide clarity for the market.
- 2.2 The speed of change in the communications sector makes it particularly important for us to have clear guiding principles. The Communications Act 2003 requires us to have regard to the principles of better regulation (i.e. regulation should be evidence-based, transparent, proportionate, consistent, accountable and targeted only at cases where action is needed). We have developed a more specific set of regulatory principles to inform our day-to-day work and evaluate our performance.

### When we regulate

We will operate with a bias against intervention but with a willingness to intervene promptly and effectively where required.

We will intervene where there is a specific statutory duty to work toward a goal markets alone cannot achieve.

### How we regulate

We will always seek the least-intrusive regulatory methods of achieving our objectives.

We will strive to ensure interventions are evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome.

We will regulate with a clearly articulated and publicly reviewed plan, with stated objectives.

### How we support regulation

We will research markets constantly and aim to remain at the forefront of technological understanding.

We will consult widely with all relevant stakeholders and assess the impact of regulatory action before imposing regulation on a market.

## Applying the principles in practice

### 3. Is the division of responsibilities, currently divided between regulator and Government, sufficiently clear?

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

- 2.3 We welcome the Government's endorsement of independent regulation and wish to set the boundaries clearly between itself and regulators.
- 2.4 Clearly articulated duties provide stability and certainty for investors. While it is right the allocation and prioritisation of responsibilities retains some flexibility, changes should be considered carefully. If they are too frequent they could reduce certainty and act as a disincentive to investment.
- 2.5 As background, we provide an overview of the current articulation of our powers and duties and our systems for prioritising work.

#### Statutory framework

- 2.6 Ofcom was established when Parliament brought together five legacy regulators working in the communications sector through the Office of Communications Act 2002. Our duties are set out in the Communications Act. If we identify an area where the division of responsibilities is unclear, we work closely with the Government to ensure it is appropriately allocated.

#### Setting priorities

- 2.7 The Communications Act gives us duties we must fulfil and powers we can use. It also includes provisions for prioritising these duties in the event of a conflict. These duties and powers and their prioritisation implement UK and EU legislation, and they are specific and outcome-focused. For example, section 3(2) of the Communications Act details the things we must secure when carrying out our functions, such as the optimal use for wireless telegraphy of the electromagnetic spectrum and the availability of a wide range of electronic communications services.

#### Contributing to public policy

- 2.8 In addition to our own priorities, Parliament and the Government set public-policy priorities. We are often asked to contribute our sectoral and technical expertise to these wider objectives where we have a clearly defined role and can deliver benefits in the public interest. For example, we have provided technical advice on the broadband universal service at the request of the Government.

#### Outcome-focused duties

- 2.9 Regardless of how a desired outcome is identified—whether by the regulator, by Government policy or by UK or EU legislation—it is important the regulator can determine the means by which this outcome should be achieved and has access to all the regulatory tools it needs. We have significant expertise in the underlying technology, business and financial accounting of electronic communications markets. This expertise has allowed us to regulate effectively within a legal framework of both *ex ante* and *ex post* regulation.

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

2.10 As the principles recognise, transparency is a key mechanism for keeping the market informed and giving investors clarity. Businesses need to know as much about the market as they can, including how the regulator operates and makes decisions.

2.11 We seek to operate as transparently as possible and share as much information as we can within legal constraints. Under our publication scheme, we make available a wide range of information including:

- how we make decisions, including minutes of Boards and Board Committees, consultations and details of our consultation process and our approach to complaints, disputes and spectrum awards;
- our priorities and performance, including annual plans and reports, the Communications Market Report (an annual statistical survey of developments in the communications sector), the Consumer Experience Report (an annual report on consumer experiences in the fixed, mobile, internet and digital-broadcasting markets) and stakeholder surveys;
- broadcasting codes and guidance, procedures for complaints and sanctions, codes of practice, licensing and memoranda of understanding;
- operations and expenditure, including tariff tables, Board and Senior Management Group expenses, procurement, contracts and tenders, salary scales and the salaries of senior colleagues;
- lists and registers such as enforcement bulletins and financial penalties; and
- a Board register of disclosable interests and other registers of interests.

2.12 Our website discloses the information available under our publication scheme.<sup>3</sup>

**6. Are the existing appeal mechanisms appropriate, in terms of the bodies with the right to appeal/object, appeal-hearing body, basis of appeal and role of government?**

2.13 There are effective rights of appeal in the communications sector. Appeals are heard by a variety of bodies. For example, some are heard by the Competition Appeal Tribunal (CAT) and others by the High Court. It is essential there is an effective way to appeal or raise concerns that addresses the issue as efficiently as possible.

2.14 As part of its implementation of the revised EU regulatory framework for electronic communications, BIS issued a consultation in September 2010, including a section on the standard of review in the CAT in relation to decisions we make as the UK's

---

<sup>3</sup> Ofcom, *Publication Scheme*, [www.ofcom.org.uk/files/2010/06/pubscheme.pdf](http://www.ofcom.org.uk/files/2010/06/pubscheme.pdf).

national regulatory authority.<sup>4</sup> We support BIS's position as set out in its consultation document.

## 7. How effective are mechanisms to review the operation and delivery of economic regulation?

2.15 Reviews are key to addressing the tension between stability and flexibility and ensuring the regulatory regime is fit for the current market. However, when looking at review mechanisms, it is important to consider whether they would create regulatory uncertainty. Altering regulations or structures as a result of the review may improve the market, but there is always a risk they will not change the market in the way intended or will even be to its detriment. The Government should consider whether the frequency of review might pose any costs or risks for citizens and/or consumers or have a negative impact on the efficiency or effectiveness of the regulator.

2.16 We are already subject to a number of review mechanisms:

- we constantly review the operation and delivery of economic regulation ourselves. Periodic reviews are built into the structure of the regulatory regime (e.g. we are obliged to review particular markets at regular intervals, some every three years). Reviews at fixed intervals have the benefit of ensuring everyone operating in the market knows when they will take place and their likely format and coverage. In some cases, these reviews look at how the market is operating from first principle, and assess exactly what regulation is needed. This enables flexibility as any changes are not framed by previous decisions. It also ensures regulation is designed specifically for the current market and not based on a previous, possibly outdated, regime;
- Government reviews occur through the periodic refreshing of legislation in accordance with developments in the market and political imperatives. The need for this flexible review mechanism naturally arises every few years given the fast pace of change in the communications sector. For example, the Digital Economy Act 2010 updated some of the provisions in the Communications Act, which in turn updated provisions in the Broadcasting Acts 1996 and 1990. The Government recently announced a new Communications Bill, looking across the sector and considering when and how the sector is regulated, during the course of this Parliament. The Department for Culture, Media and Sport has already begun thinking about the contents of the Bill and is due to publish a Green Paper in late 2011;
- our annual report and accounts are approved by the National Audit Office (NAO), which also periodically reviews the value for money we deliver (most recently in December 2010);<sup>5</sup> and
- we are accountable to Parliament, and our work is scrutinised by a number of committees each year.

---

<sup>4</sup> BIS, *Implementing the Revised Electronic Communications Framework*, September 2010, <http://www.bis.gov.uk/assets/biscore/business-sectors/docs/10-1132-implementing-revised-electronic-communications-framework-consultation.pdf>.

<sup>5</sup> NAO, *Ofcom: The effectiveness of converged regulation*, November 2010, <http://www.nao.org.uk/publications/1011/ofcom.aspx>

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

- 2.17 Predictability and adaptability can be balanced by ensuring there is clarity for investors about who exercises which role and what might cause change to the regulatory framework. As the call for evidence draws out, this tension can be addressed by applying the other principles, particularly accountability and focus.
- 2.18 It is for the Government to set the policy agenda and make the decisions for which it will be held politically accountable. Within the structure set by UK and EU law, it is essential the independent regulator is free to operate without political interference. It is also important regulators are free to use all the tools available to them without Government stipulation of the mechanisms by which they reach outcomes.
- 2.19 The flexibility to change regulations and some of the operations of the regulator is essential. However, as change can foster regulatory uncertainty, it should only take place when necessary and with the risk to stability considered.
- 2.20 Whatever decision is made, the scope, timeframe and likely impact of the decision should be made very clear to the market. Investors should also have the opportunity to contribute to, and/or comment on, the development of policy and be able to challenge the decision if necessary.

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

- 2.21 Cross-sector working provides benefits for the regulated sectors. Shared learning and best practice, as well as seeking cross-sector solutions to problems, can be an efficient and beneficial way to improve the operation of economic regulation.
- 2.22 There are currently many formal links between regulators, including institutions to facilitate cross-sector work. These fora provide a flexible and efficient way to address cross-sector issues as they arise. For example, we are a member of JRG, the Concurrency Working Party, the Body of European Regulators for Electronic Communications and the European Platform of Regulatory Authorities.
- 2.23 We have a number of operational memoranda of understanding in place with other organisations. There are also many peer-to-peer contacts at a working level that bring a wide range of other benefits.
- 2.24 There are doubtless ways to enhance these structures and additional opportunities for regulators to work more closely together to improve consistency. Good economic regulation should nonetheless be tailored to the market. Cross-sector work achieves the most when it responds to genuinely shared issues, so structures and processes must be flexible enough to enable shared issues to be identified without imposing approaches that would be inappropriate or to the detriment of the market.

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

- 2.25 It is important the chosen system of economic regulation is as efficient as possible and delivers maximum benefits for citizens and consumers while reducing the overall

regulatory burden. Regulators should be scrutinised on their performance in all of these areas. We have worked towards these goals in a number of ways.

### Efficiency

2.26 We have delivered six consecutive years of real-terms reductions in our annual budget since our formation in 2003. This is now 27% lower in real terms than that of our predecessor bodies. Since vesting, we have continually sought to deliver greater efficiency and value for money to stakeholders through an ongoing programme of reviews and initiatives. These have delivered efficiency savings in excess of £50m, the great majority in 2009/10.

### Benefits delivered

2.27 At the same time, we have met our principal duty to further the interests of citizens and consumers. For example, in 2009/10:

- we introduced new rules to tackle the mis-selling of both mobile-phone and landline services. We have seen a significant fall in the number of complaints since we first signalled new rules would be introduced; and
- we revised our voluntary code of practice so internet service providers give good-quality information on broadband speeds to consumers at the point of sale;
- we celebrated the fifth anniversary of community radio. Today there are 160 stations on air, with a potential audience of eight million people;
- we published our approach to how Next Generation Networks would be regulated in the future and set out proposals to facilitate the rollout of superfast broadband;
- we removed one of the last pieces of retail regulation, in fixed-line telephony;
- viewers were able to watch the FIFA World Cup in high definition through their aerials. This was a direct result of a complex project we undertook to introduce new technical broadcasting standards and rearrange the use of spectrum for digital terrestrial television; and
- after detailed investigation, we concluded Sky should offer some of its premium sports channels to other pay-TV providers at regulated prices.

### Deregulation

2.28 We are committed to reducing regulation wherever possible, as demonstrated in 2009/10 by, among many other decisions, our recommendation to the Government to remove some radio-ownership rules and liberalise other cross-media ownership rules and our decision to further deregulate fixed, narrowband, retail-service markets.

2.29 We aim constantly to improve our approach to regulation. We believe there is further scope to ensure even greater accountability and robustness in the way we regulate and are currently looking at ways to improve our impact and regulatory impact assessments and the way we measure outcomes.

## Annex 1

# Glossary of abbreviations

**BIS** Department for Business, Innovation and Skills

**CAT** Competition Appeal Tribunal

**EU** European Union

**JRG** Joint Regulators Group

**NAO** National Audit Office

**TSR** Telecommunications Strategic Review