



HOUSE OF LORDS

# Industry and Regulators Committee

## Corrected oral evidence: UK regulators

Tuesday 21 November 2023

10.30 am

Watch the meeting

Members present: Lord Hollick (The Chair); Lord Agnew of Oulton; Baroness Bowles of Berkhamsted; Lord Burns; Viscount Chandos; Lord Clement-Jones; Lord Cromwell; Lord Gilbert of Panteg; Baroness McGregor-Smith; Lord Reay; Baroness Taylor of Bolton.

Evidence Session No. 5

Heard in Public

Questions 39 – 48

Witness

[I](#): John Penrose MP.

## Examination of witness

John Penrose MP.

Q39 **The Chair:** Good morning. This is the Industry and Regulators Committee inquiry into UK regulators. I am delighted to welcome our witness today, John Penrose, who is the MP for Weston-super-Mare and author of an independent review of competition policy that touched heavily on regulations, which is the subject we want to talk about today.

John, perhaps I can start by asking you a rather more general question about the remits and rules covering regulators. In your inquiry, did you come to the conclusion that those remits were clear or unclear—that they were sufficiently narrow to be followed through, or so wide as to confuse the regulator?

In this committee, we have now met with and investigated eight regulators, and it would be fair to summarise by saying that there is a feeling that there are too many aspects to their remit. Quite how they should prioritise those parts of their remit is not entirely clear, and it is not necessarily clear from the Government as to what they want. You were very clear in your report about what you thought should be front and centre in terms of regulation, so it would be very useful to hear your thoughts on that today.

**John Penrose:** Thank you, Lord Hollick, and thank you for inviting me here this morning. You are right. My report was slightly broader because it was talking about competition policy more generally, but the economic regulators in particular are a core part of that. I should, therefore, say that most of my remarks will focus mainly on economic regulators. I appreciate that there is a whole slew of others of whom I do not have quite such direct experience, so I will leave other witnesses to fill in those gaps.

When it comes to economic regulators, of which there are eight at the moment, I am probably going to agree with your opening remarks, in that they have a variety of remits. The CMA, at one end of the spectrum, has one statutory duty, which is competition for the sake of consumers. We are about to add a bit more to that in the competition Bill, which, as of last night, is winging its way towards your Lordships. It has, broadly speaking, one duty and has had for some years. At the other end of the spectrum, the Office of Rail and Road has knocking on two dozen duties. Many of them have secondary duties, “have regards to”, and this and that. Those add to the complexity, which I think was your lead-in presumption. I would, broadly speaking, agree with that.

The danger with anything approaching a large number is that, inevitably, after a certain number, that requires the regulators to prioritise for themselves. Therefore, that often means that they are being dragged, whether they like it or not, into political decisions when they make those prioritisation points. It also means that it is almost impossible for them to deliver on everything at once, either due to questions of resourcing or because the whole breadth of those duties is just too broad.

One thing that is clearly a problem for some regulators, although not all, is that they have had scope creep over many years. Many of the economic regulators have now been around for 45 years or so and, over that time, have added and gained extra responsibilities. When I was in business, I was always told that, if you have more than about four key performance indicators, the one thing you can be sure of is that some of them are not key. I would suggest to the committee that that is probably the case for statutory duties as well, and so, if you have more than a fairly small number, you have a problem.

Even where you have a small number, if those duties are widely divergent or separated, just because, as in many cases, non-economic regulatory duties have been bolted on the side—the ORR has health and safety, for example, which is very important—you end up with a remit that is too broad. Therefore, inevitably, if you end up focusing on one thing because it is urgent, other important things may be disregarded, to the long-term detriment. I am agreeing with your central point but embroidering on that.

**The Chair:** One of the regulators that we looked at in great detail was Ofwat. The issue of the level of investment needed over two decades had to be balanced against the level of charges to consumers. At the end of the day, we concluded in our report that that was a political decision and, therefore, it was difficult for the regulator to make its own economic decision on that. Indeed, as a result, water rates were kept at a very low level, which was very good for consumers in the short term, but, in the long run, there is now a very substantial backlog of investment that is needed. That was one of the contributory factors to the problems with pollution in rivers.

Looking at that issue of balancing bills against investment, the pull between the two and the need to balance them, how does an independent economic regulator juggle with that and get the right point of balance?

**John Penrose:** That is a really good and current example of the kinds of pressures they are under. I am completely with you. I would argue that it is not just them being asked to make political decisions. Over several decades, there has been quite a lot of political pressure to, exactly as you have described, prioritise short-term levels of bills over anything else.

Part of the job of independent regulators in particular is to be able to look Ministers straight in the eye and say, "That's fine, Minister. Thank you for your view, but I've got a statutory duty to do X or Y", provided the number of those duties is not too high. "I hear your short-term urgings, but I've got to do the following things, because I've got legal duties to do them, which I can't ignore". To link it back to your earlier question, if you have a sufficiently clear, unambiguous and short list of priorities, what you would then expect senior regulators to be able to do more effectively is to stand up where necessary, to speak truth to power to senior Ministers and to say, "There are other things here that you're urging me to fall short on".

It is argued quite widely that that is what happened with water, in that it was not just that political decision-making was the problem, but that regulators were both very detailed in some of the analysis that they were doing, which was not necessarily very helpful, and a bit soft when it came to trying to hold the investors in and owners of water companies to account for what they were required to do. That is not just something political but is also a question of regulatory backbone, if I can put it that way.

**The Chair:** We are going to come to the question of governance, culture and resources during the course of this session, but it is fair to say that, of the eight regulators that we have looked at, we have yet to find one that had taken a view that was unpopular in terms of pricing for the Government. Maybe there are some out there, but they are rare indeed.

**John Penrose:** In other ministerial jobs, I have seen non-economic regulators have what you might call difficult conversations with Ministers and say no, but that is a different conversation.

Q40 **Lord Agnew of Oulton:** Good morning, John. I am interested in your thoughts on the issue of Governments almost abrogating responsibility for difficult political and distribution decisions by, basically, placing them in the hands of the regulator. Linked to that, do you feel that regulators are able to be properly independent?

**John Penrose:** Water and energy are very good examples of this, where there are, historically, all sorts of distributional questions about whether you charge people the same cost for different elements of the utilities they get, depending on whether they live in rural areas at the end of a pipe or a wire. I am completely with you, in that these are inherently political decisions in many cases, although not all.

I would argue that, if you have the right statutory duties, going back to Lord Hollick's initial question, Parliament can legitimately hand over some of those responsibilities, certainly to economic regulators, and possibly to others too, because a political decision has been taken, a mandate has been handed to the regulator and the regulator is then provided with the political body armour to get on and do the job.

That is a very different situation from leaving the regulator without that clear mandate, or with a confused mandate, as we were talking about earlier on, and the regulator having to make the trade-offs. That is a very uncomfortable situation for many regulators to be in and is not one that we, as parliamentarians or Ministers, should want to put them in, because it leads to a very difficult position.

It is also economically inefficient, because the more political uncertainty you have, particularly for economic regulators, the more of a political and regulatory investment risk premium you build into the cost of capital for these industries. There are plenty of people with serious economic experience around this table, so you do not need me to remind you that an increase of a couple of basis points in the cost of capital due to

uncertainty created by us is worth a great deal of money for multimillion and sometimes multibillion-pound investments with an asset lifespan of between 20 and 40 years. It really matters.

I would make a further point adjacent to that. The idea, therefore, of an arm's-length, politically independent economic regulator is, fundamentally, still really important, really sound and very desirable. I am a little worried that there are a few more political reach-in powers being created. There are a couple, for example, in the competition Bill, which, as I said, is coming your way.

If that becomes too much of a habit—saying that the Secretary of State has to sign off on, for example, CMA guidance on this and that—the number of points of access for lobbyists and points of potential unexpected change, and, therefore, political and regulatory risk, go up. Therefore, we may be eroding that rather important and valuable central principle of, wherever you can, creating this arm's-length political certainty in order to make a sensible regulatory environment.

**Lord Agnew of Oulton:** Linked to that, should Parliament have more oversight of the appointment of these senior regulatory people? For example, we looked a few months ago at the Office for Students, whose chairman is a Conservative peer who has not resigned the Whip, which we felt was wrong. How do you show truth to power if you are still in the tribe and have been appointed almost as a matter of patronage?

**John Penrose:** It is a historic point, but I should probably declare a historic interest, because my wife was in a senior position in health regulators. She had not, I do not think, resigned the Whip at that point and there was some discussion of it, so I am a bit biased regarding answering that question and should probably recuse myself, if you do not mind.

**Lord Agnew of Oulton:** I would be interested to hear your defence—not of your wife but of the situation that allowed this to happen.

**John Penrose:** I have long since given up trying to speak on behalf of my wife. One way or another, it is usually a very dangerous place to be.

There is absolutely a point about Parliament taking a view on the suitability of senior appointments, not just in regulators but elsewhere too. It is hard for Parliament to balance where these positions are then going to be politically at arm's length, because it needs to behave in quite a non-tribal way. That may be something that your Lordships are better at than the Commons, because it means that you have to put aside the day-to-day cut and thrust of party politics in order to make a completely disinterestedly meritocratic decision. That is probably all that I can say at this point without straying dangerously off the point I was trying to make about recusing.

Q41 **Lord Clement-Jones:** Good morning, John. I have two questions. The first is quite a general one, but it would be very useful to have your

perspective. Are the roles and remits of regulators sufficiently discrete, or is there overlap and duplication in their responsibilities? What is the impact of this on their performance?

**John Penrose:** Between economic regulators, there is huge overlap in principle. Most of the competition powers, for example, held by Ofgem, Ofwat and Ofcom, et cetera, are also held by the CMA, so there is concurrency, which is the term that they always use to describe it.

They avoid trampling on each other's toes or parking their tanks on each other's lawns—choose your metaphor—with a series of exchanges of memoranda of understanding between them. In my experience, that seems to work reasonably well. They each often have views about whether the others are exercising their powers in their particular patches well or badly, but they do not tend to migrate and they manage to stay in lane.

There is also the UK Regulators Network, which I am sure many of you have come across, where the senior representatives from economic regulators get together to compare and contrast their approaches and, where necessary, try to exchange best practice, if I can put it that way. I hasten to add that I have never been to the meetings and am not invited. It would not be right for them, and they would not feel right with a politician in the room, I am sure, but they seem to feel that that is valuable for them and they find it useful, so that is quite helpful.

In parentheses, the difficulty we have with individual sector regulators is that the risk of capture is a little bit higher than it is for a cross-sector regulator like the CMA. I do not know if you are going to come on to that later, so I will not stray on to it now, but that is more of an issue to do with concurrency rather than parking tanks on lawns.

**Lord Clement-Jones:** Yes. I am with you. You have answered my second question, which was going to be about co-operation between regulators. Of course, you could also have quoted the DRCF and things like that. We have just done a report on the water industry, and I am quite interested in the fact that, by and large, you think that this overlap is not too much of an issue, whereas you could describe that as a pretty good example of the duties, by not being that clear, causing real issues in that industry.

**John Penrose:** Can you give me an example of the sort of thing you are thinking about, where the duties were not clear and caused a problem, so that I can make sure that I respond properly?

**Lord Clement-Jones:** Examples would be the Environment Agency, Ofwat and various other agencies that have duties in respect of water, sewage and so on.

**John Penrose:** I am probably the wrong person to ask. You will have to push that with other witnesses—the overlap between economic and non-economic regulators. I am certainly aware that people complain about it

vociferously and loudly, so I am sure there is an issue there, but I am afraid I am not the right person to answer that in detail.

**Lord Clement-Jones:** That is fair enough. Let me take another example, in that case. Given the turf war, sometimes, between the CMA and other regulators with a competition duty, such as Ofcom, do you think that works in a reasonably coherent way?

**John Penrose:** Yes. My criticism of some of the sector regulators would not be that tanks have been parked on lawns and that they are tripping over each other. My criticism would be that being a sector regulator sometimes means that you are more at risk of being captured by the people you are regulating. Therefore, some of them have been too soft at some points in their history, but that is answering a slightly different question than the one that you are asking, so I will hold fire on that until we get to that, if you wish to.

**Lord Clement-Jones:** Of course, there is a value judgment as to whether tanks on lawns are a good or a bad thing.

**The Chair:** There is one example that has arisen in our hearings. We looked into the LDI pensions crisis and there were three regulators—the Pensions Regulator, the FCA and the Prudential Regulation Authority. All three of them missed the devastating impact of leverage.

**John Penrose:** This tends to come up more often in highly innovative, fast-moving sectors. It is potentially a difficulty in telecoms, where the pace of technology is changing quite quickly, but certainly in finance people are endlessly creative. New instruments and products are being created all the time.

There are regular conversations, and I am not quite sure that there is a rapid enough response to the conclusions of regulators saying, “We have our legal frameworks and our foundational legal powers. They do not equip us to regulate that new product over there”, be it crypto or something, “and so we can’t do it legally. It is ultra vires for us. Go and try the adjacent regulator over here”. The adjacent regulator says, “No, it’s not us either” and then you end up with something in between. I would argue that that is a problem for this building and Ministers rather than the regulator, and they will get sued pretty quickly if they try to do stuff that is beyond their legal foundations.

Q42 **Baroness Taylor of Bolton:** Can we develop that theme about Parliament and accountability, or, indeed, government and accountability, and the regulators? You have seen things as a Minister and as a parliamentarian. We have regulators that have to have a very high degree of independence and backbone, as you said, which is a very good way of putting it, and yet somebody has to hold them to account.

You have talked about Ministers having priorities that perhaps meant that Ofwat went soft on pricing and, therefore, the investment was not there. Should we have a system for Ministers whereby there is greater clarity in any direction that Ministers want to give to a regulator, so that it is not

the regulator getting the mood of the moment from Ministers, but getting some clarity about who is making the decision? Every so often, Parliament looks at this regulator or that regulator, but there is not a consistent oversight. Could you comment on whether we need that?

**John Penrose:** You have asked two related questions. Let us start with the ministerial one and then move on to the parliamentary one, if you are comfortable with that.

In ministerial terms, there is already a mechanism, certainly for economic regulators—I do not know about others—whereby, by convention rather than anything else, there is a once-a-Parliament strategic direction. In my experience, that is not always used and, when it is, it tends to be a densely worded, largely impenetrable four-page or sometimes even 10-page letter, which sits on top of the statutory duties that we were talking about earlier.

You are right that the danger of any political reach-in, the economic downsides of which we talked about, is that it tends to be driven by short-term urgency rather than long-term importance. I agree that that is always a danger. The strategic direction mechanism is at least a way of trying to formalise that and make it less frequent, more black and white and more transparent, which is good.

I just worry that, if we start to expand on that very much, the danger is one of more reach-in or more points of pressure, which supposedly independent regulators will then have to have stronger backbones to resist, so we need to be really careful about controlling that mechanism. There are plenty of unofficial, informal ways in which Ministers can exert pressure anyway. I do not think that we need to create any more.

On the point about parliamentary responsibility and accountability, yes, absolutely. I am afraid that, with the honourable exception of those here present, this is a politically unsexy, rather nerdy area. It is really important, I would argue. It does not get nearly enough attention or focus, certainly at my end of the building. As a result, I do not think we are terribly good, as a breed, at taking account of what happens.

The number of Commons Select Committee sessions on the regulators in each department's purview is pretty small. They are pretty infrequent, and they tend to be relatively cursory and not done in any huge detail. I am not sure that I know what the right answer is for strengthening that, but I am pretty sure that what we have at the moment is not working terribly well.

**Baroness Taylor of Bolton:** Should Select Committees have more of a specific responsibility for looking at the remit and doing an annual report, for example?

**John Penrose:** Having been on a Select Committee or two as well, although your Lordships will take your own measure of this, my instinct is that they need a reason to focus on a particular area, because an entire department is a big thing. I appreciate that this is a cross-departmental



committee with a slightly different remit. My experience is that they need something to get their teeth into—a report, a piece of data or a target hit or missed, regularly reported on and reliably evidenced—and they need a moment of theatre in order to focus attention. A target, hit or missed, is a good example of that.

That is probably what we do not have enough of in this area, and we probably need to do some quite detailed thinking about how to create those mechanisms in order to get people to turn up for sessions like this properly. You guys are, I am afraid, an exception rather than the rule, and I wish that there were more like this.

**Baroness Taylor of Bolton:** The problem is that, if it is a crisis, it is probably too late—it has to be done urgently. That is where the “unsexy” issue that you referred to comes in. That is why I am wondering whether we could build into the responsibility of Select Committees some aspect of supervision and holding to account of the regulators in any area, but I accept that you are saying that it is difficult.

**John Penrose:** The chairs of the relevant departmental Select Committees, certainly in the Commons, would argue that they already have that responsibility. Our task is probably to create those moments of theatre that make them more likely to want to do it, perhaps on a regular basis, because there is something important coming out. At the moment, the only one that really does that automatically is the Public Accounts Committee, or something like it.

**Baroness Taylor of Bolton:** We are going to hear from the Public Accounts Committee shortly.

Q43 **Lord Gilbert of Panteg:** My experience is in digital regulation, and I previously chaired the Select Committee here that looked at that. As we move to principle-based regulation across most of the regulators, does Parliament have a role in understanding how regulators are applying those principles? They are creating, effectively, tertiary legislation, which is a really powerful responsibility. Previously, a lot of this would have been done by Parliament in a different way, but the very fast-moving digital world means that it is the only way to create regulation. Is it legitimate for Parliament to try to have an understanding of how those principles are being applied?

My second thought is that you talked about the co-operation between regulators, which Parliament does not really scrutinise. It scrutinises the individual regulators but not how they are working together. The Digital Regulation Cooperation Forum, for example, brings together five or six regulators in the digital space. They share best practice and information, but they increasingly work together, and that is beyond any scrutiny. The individual regulators are scrutinised but not the working together. Is that an area that Select Committees ought to be looking at?

**John Penrose:** That is a really important point, because, certainly in the Commons, with departmental Select Committees, it is entirely possible for a Select Committee to look at the way that three regulators have

addressed digital issues, for example, if they all come under the remit of DCMS or DSIT, whichever the relevant department is. If, on the other hand, they are scattered across three departments, you will have to have a grown-up conversation between the three Select Committee chairs, which does happen. You end up with joint committees being formed in order to do that stuff.

It is less likely in this area, for the reasons I explained in my earlier response, because we do not have the moments of theatre that get the Select Committees to focus in the first place. In my experience, Select Committees are perfectly capable of forming Joint Committees, sub-committees or whatever it might be, in order to deal with it, but I take the point that that co-operation is very important and absolutely should not be ignored.

On your first point, it is totally legitimate for Parliament to take an interest in tertiary-level interpretations and creations, although we need to be a bit careful. The closest analogy, although not a perfect one, would be in common-law decisions by courts and stuff like that. Ultimately, if Parliament does not agree with a court decision on X and Y, it is not and should not be up to Parliament to criticise the decisions of the judges. It should be for Parliament to say, "We don't like where that has reached and we will, therefore, pass a statute in order to change it".

That parallel is instructive for looking at what the individual regulators are doing here. It allows that political arm's-length reducing of political interference risk to take place responsibly, but without just writing a blank cheque and saying, "Fire and forget. We won't look at this for another century", because that clearly would not be responsible.

**Q44** **Baroness McGregor-Smith:** On the transparency of regulators and their own performance, it is quite interesting if you are a regulator and you have to decide how good your performance has been over a year and how you report on that. My first question is really about the key metrics that should be used to determine and evaluate a regulator's performance.

Secondly, I am very taken by some of the evidence that we heard on water in particular. Over a significant period, companies were allowed to really gear up and leverage, and nothing was done about that. If all those companies had been in, say, the public market—one of them is, but most of them are not—there would have been more of a self-regulatory view around leverage, because the markets would have controlled that more. Here, there was a real gap, where either a regulator did not get involved—I am not sure—or, if it did, significant levels of leverage still happened, which has really hurt the water companies now. I am interested in your views about the key metrics that should be used to evaluate performance, particularly with what we have seen in water.

**John Penrose:** Let me start at the end of your point about market valuations and that sort of stuff, because you are absolutely right to point out that there are not many of those. There are many data points in, for example, water, and it is hard to read across from there to any of the

other organisations in that sector, let alone to energy or something like that.

One thing that has happened over the last 40 years—or, to be slightly tongue-in-cheek, ever since people invented spreadsheets that allowed them to start modelling things in more detail—is that, particularly for the regulators that have to do price setting for the network monopoly piece, at least, of what they are running, that modelling exercise has become ever more baroque, complicated, detailed, expensive and slow, but not noticeably better in its outcomes. In fact, you just gave a really good example of why many people are highly critical of some of those outcomes, at least after the fact.

We have a really big problem there, which probably means that there needs to be a fundamental rethink about how most of those regulators, run by well-intentioned, clever public service people with all the right motivations, have ended up in this place. They are trying to do something that is probably impossible, which is to model more and more of a very complicated industry in order to fill in gaps. Can we get back to something that says that nobody is that clever, but that there is a market-based answer, an auction-based answer or something else that will get rid of the battle of the spreadsheets in as many parts of their operation as possible?

If you talk to historians in this area, they will say that that is the way in which some of the original economic regulators, back in the 1980s when these things were first started, envisaged working, and we have moved a very long way away from that instinct. If you can do that, you can strip out a vast amount of delay, cost and regulatory jeopardy, because no one is that clever and, therefore, they get things wrong, so you end up asking questions, entirely legitimately, that many others have asked as well. It will take a really fundamental rethink, and this would probably apply not just to Ofwat but to others. Ofgem may be part of that as well.

There is an interesting comparison between those that have to do that and some of the other economic regulators. The CAA, for example, in air traffic control, has managed to marketise and reduce the amount of spreadsheet-able areas in its areas of authority very dramatically indeed. While it is not immune from criticism, there is much less scope for honest but very serious errors being made, which come home expensively to haunt us later. That is a long answer to the first part of your question.

On your second point, about what we should be measuring, I would argue for more market stuff, which, therefore, gives you auction-based outcomes or whatever it might be. There are some things that we should, none the less, look at. I am quite impressed by the CMA, which does an annual analysis of the direct economic benefits and costs of what it does. That goes to your question about whether it is marking its own homework, how independent that can be and whether someone else should be checking it over, et cetera, but the principle behind it is pretty good.

You want to bear down on the regulatory burdens being created by these organisations, particularly those with ex ante powers, so all of the economic ones. We have not been good at that in the past at all. You also need to accept that those regulations can be doing something very valuable and important for a modern economy. You do not want to have no regulation, but you do want to make sure that, when you produce that regulation, the benefits wildly outweigh the costs.

You could envision somebody saying, "We are going to publish that each year, independently audited or analysed, and we are looking for a minimum ratio of 5:1", or something like that. You could see why that would create some really useful pressures on regulators. If you managed to get 5:1 every year, for example, which is just a number that I have pulled out of the air rather than something based on detailed analysis, you can see why that would drive up the productivity of those sectors progressively and steadily, year on year, over time as well. That would be a starting point to look at.

- Q45 **Viscount Chandos:** Could we go on to the human side of regulators? You have referred to a possible lack of backbone and Ofwat being a bit soft. That comes down to the people and perhaps, to a lesser extent, the resources. From your experience, what is your impression of the culture and resources regulators have had?

**John Penrose:** As I said earlier on, almost without exception, every regulator I have met has been clever, well intentioned, motivated by a public service ethos and all those things, exactly as you would want. Many of them are also very impressive. I do not think that regulatory capture is something that happens by design at all. The Penrose shorthand is that, at any one time, roughly one and a half of the economic regulators are captured, but it is just never the same one and a half. It depends on when you have had a new chairman or chief exec, and all those things.

It is not fair to say that any one of them—Ofwat or whichever—has been supine throughout. The point is that they go through cycles, as do their activities. If you have a five-year price setting review, there is a five-year cycle to that important piece of work, and the pressures go up and down during it as well.

The dangers are two-fold. One is that, because you get cycles of work, you get people who arrive at a particular point in the cycle. They do the hard yards whenever the difficult bit of the price setting piece is. They then have learned a vast amount about the water or energy industry, depending on which regulator they were at, and they then become incredibly valuable to the firms that they were previously regulating, so their market value is enormous outside.

Also, from a creative element point of view, relatively speaking, it is going to be much less interesting for the next couple of years until the next cycle comes up, which might be five years hence. Many senior regulators would argue that it is hard to hang on to your best staff, not

because they are necessarily good or bad employees, but just because of that cyclical thing.

Incidentally, it is easier for a cross-sector regulator, because those cycles will not match up and, therefore, you can move people around. You therefore get better comparisons. They will say, "We didn't accept that argument when Macquarie made it for water. Why on earth should we accept a similar argument when a different investor makes it in energy? I was there and here's how we argued it". You get much better collective wiring and in-depth understanding about that if you are able to move people around. That is much harder in a single-sector regulator, for that reason.

I have not heard many other people say that, for example, being funded by the firms you are regulating creates any impossible problems. Most people do not seem to feel that it creates that much of an issue, because the funding is a mandatory thing rather than anything else, so you do not have to spend time lunching your benefactors or anything like that. If it is, it is so subtle that no one has ever mentioned it to me, let me put it that way. Having not worked at a regulator, I would not have observed it.

That is a perfectly respectable way of doing it. Again, going back to the earlier question about what the right things are to measure, you would want to try to put more pressure on regulators to simplify what they are doing in order to reduce their costs, but that is a slightly separate question.

**Viscount Chandos:** You focused rather on the gamekeeper turning poacher. There is also the issue of poacher turning gamekeeper and what the balance of desirability is of hands-on industry knowledge within the regulator, but without encouraging regulatory capture. In different sectors, there are different traditions of the extent of that interchange.

**John Penrose:** This is rather equivalent to the debate that we regularly have about Ministers adhering to ACOBA rules about moving into and out of government, and senior civil servants as well. Probably the same arguments apply here too, in that, if it is properly managed, there can be real value in having somebody coming into the regulator who knows where all the bodies are buried in the industry, or vice versa. The potential for conflicts of interest is also real and, therefore, needs to be managed properly. It is not automatically bad and there is, potentially, real good in it, but it has to be managed very carefully.

In those conflict-of-interest management processes, it is not a question of whether there is a conflict of interest—there often is—but of what you do when you find one in order to manage it properly. That needs to be dealt with, but I do not think we should be assuming that it is automatically bad and we should always try to stop it.

**Viscount Chandos:** In terms of speaking truth to power, you said that, from your ministerial experience, there were regulators that were quite ready to do that. I do not know whether, by inference, that suggests

that, looking from the outside, the regulators that you have looked at have not really had that as an endemic part of their culture.

**John Penrose:** I have not been in the room for the private conversations between the people who run the economic regulators today and the relevant Secretaries of State, so I do not know what tone and tenor those have. For those industries that are in trouble in terms of the value we all think they are providing to their customers—and to the extent that, by popular conclusion, that is caused by poor regulatory decisions, in some cases over quite a long period in the past—I imagine that, if I was a senior regulator running one of those organisations, I would feel like I was on the back foot when I walked in the door. I do not know whether that creates a difficulty for them when they get through the door, because I have not been in the room.

**Viscount Chandos:** Following our recent inquiry into the OfS, we all came away concerned that, at least in its conversations with the sponsoring department, it was not looking very much into the future regarding the financial sustainability of the sector.

**John Penrose:** I am afraid that that is not an area I have focused on, so I will have to cede to your superior knowledge of that one.

**The Chair:** A number of our witnesses raised the question of rising stars in the Civil Service being put in a position where, clearly, they are looking for further preferment, which would, therefore, somewhat compromise their attitude and, indeed, to use your word, backbone. Is there a danger that, in fact, that causes a problem?

**John Penrose:** There is a fundamentally different purpose of being an arm's-length regulator and a Whitehall civil servant. The job description ought to be different, I would argue, because a civil servant is supposed to do their best for the Government of the day. The head of an economic regulator is not supposed to do their best for the Government of the day, but is supposed to fulfil their statutory duties on the presumption that those have been put together properly, as we started with. That requires a different attitude, and you would require a high-quality person to have clocked that and to have drunk deeply from the new well before they took up the new role.

Q46 **Lord Reay:** Good morning. Do regulators engage sufficiently with consumers? How does this compare with regulators' engagement with businesses? What impact does this have on regulatory decision-making?

**John Penrose:** Lots of regulators—and certainly the economic regulators—have the consumer council for X and Y. Those bodies, if well run, can be really helpful. They can make sure that you are not ignoring marginalised consumers, that there is proper access and that people who are vulnerable are not being forgotten. They can play a really valuable role.

The bit that would worry me slightly is not that, but that, in listening to those bodies—and they make important points—the danger is that an

economic regulator may forget that its main job ought to be, in my view at least, competition for the benefit of consumers. Its job is, therefore, not to try to work out what consumers want and to order companies to do it, but to empower consumers so that they, through their choices and market decisions, can give that information directly to the companies concerned, rather than mediated via the regulator.

That is part of the problem that goes back to the point about the battle of the spreadsheets and trying to model ever more and more about what goes on in an industry, which is fundamentally an impossible and self-defeating task. Many of them make great efforts, but there is a limit to what those things can do; however, if you get out of the way, empower consumers and let them talk directly to the firms you are regulating, that may be a better way of doing it.

**Lord Reay:** Your report suggested that, for instance, the CMA could do a better job.

**John Penrose:** There are some more fundamental questions about what is fair for consumers, if that is what you are driving at. The difficulty with society's conception of what is fair and what is, therefore, doing the right thing by your customers is that society is not a static thing, thank goodness. Society's opinions move. Therefore, you can be doing something that is perfectly reasonable today; then there is some sort of social or political convulsion and, all of a sudden, you are on the front page of the tabloids for being a beast and doing something that is awful tomorrow.

It would help if the CMA did a bit more to try to work out what fairness looks like in advance. It is not possible to do this precisely or permanently, but, to Lord Gilbert's point about tertiary legislation, if you can come up with an intuitive rule that tells business leaders roughly where fairness ought to be in advance, the chances are that it would be very valuable to be able to say, "Here's the heuristic decision-making mechanism that will allow me to get it right, probably, without having to reach for a lawyer every single time or run the risk of getting stamped on by a regulator".

I was suggesting in my report that there is something called transactional fairness, which a bunch of academics came up with. That may or may not be the right version, but a rule of thumb that allows business leaders who are risk averse and do not want to try to find the bleeding edge of where the regulators are to say, "If I'm doing something that is roughly in line with these two or three principles, I'm probably safe most of the time", could be very valuable indeed. It might be something that the CMA or others could usefully do for the productivity of Great Britain plc.

**Lord Reay:** You made a number of recommendations in your report. What was the response to your recommendations on competition policy? Do you feel that the regulators have listened to and implemented your recommendations?

**John Penrose:** It depends on my mood on the day you ask me that question and whether the glass is half full or half empty. I did an 18-month update called *Unfinished Revolution* after my initial government-commissioned report, which had a scorecard on it. Since then, things have moved on.

The glass is more than half full now. The competition Bill is doing an awful lot of the things that I was suggesting in *Power to the People*, the government-commissioned report. The data Bill is also doing a collection of things about smart data, which are incredibly important and are part of my recommendations. The Procurement Act has also done a collection of things that are important.

Broadly speaking, the answer is yes. However, there are still some omissions. We had a conversation and a debate yesterday in the Commons about better regulation and regulatory burdens. I am pleased to tell you that we got some commitments from the Minister at the Dispatch Box about trying to do more in that area, and I am going to be forming a little group of ankle biters to make sure that those are delivered on. That is an area where we are still underplaying it.

I worry that our recently passed rules about government subsidies—we put through some legislation on that about a year ago now—might leave a bit too much play for political interference, but we will see about that. History will show us, and a bit of post-legislative review will allow us to gauge whether my fears are legit or I am being overly worried.

Broadly speaking, there has been quite a lot of progress in quite a lot of important areas. The bit where we still have problems is in this area of economic regulators and their statutory duties, and getting them to focus more closely on competition for the benefit of consumers. That is still unfixed and would be my major area now, although, if you had asked me before yesterday's debate, I would have added in better regulation as well.

Q47 **Lord Cromwell:** Good morning. Can we focus a little more on competition as an objective for regulators? Opinion seems to fall very much into two different camps on this. I totally get the interest in competition on behalf of consumers locally, if you will, but what about the international competition side? There is an element of, "Our regulators are too strict and there is a race to the bottom if we let slip".

There are two counterarguments. The first is that our USP as UK plc—forgive all the acronyms—is that we are quite a cautious regulatory environment, which is not such a bad kitemark to have, and that you risk throwing that away if you make international competition an objective of the regulator.

Secondarily, competition links to economic growth, which is a responsibility of the government economic policy of the day and is not the job of regulators. How do you feel about the international competition aspect of regulators' objectives?



**John Penrose:** I am afraid that I do not have much truck with the underlying assumption of that argument, because I do not think that there is an either/or choice between domestic competition and international competitiveness, if I can put it that way. In fact, I would argue quite the reverse: that the more competitive the UK economy is in every single sector and the tougher the competition is here, the more likely it is that companies based and operating here are going to be successful in export markets. The phrase, "If you can make it here, you can make it anywhere" applies in spades in this area. The dichotomy which I appreciate you were not necessarily espousing but explaining is fundamentally a misconceived starting point for that.

Therefore, we should be aiming to have the most competitive markets on the planet, ideally, in every single sector of our economy, because it equips us to be more effective internationally and successful in export markets. What it does not mean, therefore, is that you should have capricious regulators. To your point about caution, it is something that we can have and, I would argue, should have at the same time. There should be cautious, evidence-based, steady and predictable steps towards the toughest competition that you can have. Those two things should not be in conflict with each other.

**Lord Cromwell:** You will appreciate that the culture of many a regulator will be towards caution rather than adventure. Are you not heading in the direction of having regard to competition rather than it being a core objective?

**John Penrose:** I am not sure that I understand your question. I am arguing that the caution is that you need to be evidence-based and predictable in the direction you are taking, but that you are utterly ruthless about the fact that the direction you are taking is in favour of ever stronger and ever tougher competition. Have I misunderstood your question there?

**Lord Cromwell:** Let us take a structure and suppose that regulation in country X, which is economically very successful, is less cautious than ours. Should we copy it or hold to our USP of being more cautious?

**John Penrose:** It depends on why country X is successful, to your point about economic growth being the responsibility of government rather than just the regulators. It is entirely legitimate for us to say that economic growth for the benefit of consumers is a really good central principle for not just the CMA but, I would argue, many other economic regulators, because competition is only one part of economic growth. It is an important part, but we have also given responsibility for interest rates, on a political mandate with a statutory duty, as we were talking about earlier, to the Bank of England on the same basis.

It is entirely reasonable for Governments to give discrete bits in a black box to a regulator to manage those pieces properly, with some very strong guidelines, duties and accountability. This is another example of that, I would argue, but that does not mean to say that, therefore,

Governments should abrogate all their responsibilities. There is still a heck of a lot more about economic growth than just competition policy, competition regulation or interest rates. There is a whole range of other things, such as skills, which I am sure everybody is comfortable with, that matter too. Again, it is probably a false choice. We can and should have both.

- Q48 **Viscount Chandos:** Is competition always the best way of protecting consumer interests? I am thinking, for instance, of the approach taken to Premier League football rights. For the consumer, it seems to push the price up of being able to watch as many matches as possible. It may have benefited the clubs, but has it benefited the consumer?

**John Penrose:** That is why I talk about competition for the benefit of consumers. That is the second half of the CMA's statutory duty. It really matters, because you can have competition that benefits producers or monopolists, so you need to try to create and capture consumer surplus in order to make sure that this works in a modern, liberal, capitalist democracy. Otherwise, you very rapidly lose consumer consent and willingness to go along with it. I am not familiar enough, I am afraid, with the football industry to know which bits of that might mean that fans got a better deal, so I will leave that to football experts.

One of the things that has made me most reassured about the competition Bill, which, as I said, is coming to you guys in a minute, is that it has built into it some very important clauses that say, "You can come up with ex ante conduct regulations on this or that for whichever sector you want to do it for"—it might be football or anything else—"but, ultimately, we want you, please, to look at pro-competitive interventions rather than just conduct regulations". That strikes me as a really vital piece of discipline for any economic regulators to have. Otherwise, you end up with more and more conduct regulations and regulatory burdens, as we were talking about earlier, and you do not do the underlying reforms that may solve the problems at birth, prevention being better than cure.

**The Chair:** John, thank you very much indeed. That has been a very helpful session. We are seeing the CMA next week, so we look forward to the session with it. You are putting it very much front and centre as part of regulatory policy, and we will be interested to see how comfortable it is with being placed in that position. Certainly, Andrew Tyrie, who gave us some testimony a few weeks ago, expressed some fairly serious reservations about its performance, so we will look forward to next week. Thank you very much indeed for letting us hear from you.