Theorising Utility Regulation*

Teorizando a regulação dos serviços públicos

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ABSTRACT

This article argues that utility regulation remains a central and enduring feature of modern governance, despite liberalisation and expanded competition. Developments in the United Kingdom, the European Union, the United States, and post-privatisation states demonstrate that regulatory institutions continue to play a decisive role. The author critiques two dominant theoretical models: the bilateral or contractual approach, including capture theory, and stakeholder theory, which situates regulators within a network of competing interests. Neither framework adequately explains the complexity of regulatory practice or provides a sound basis for reform. The article proposes a return to political and constitutional theory, advancing a rights-based approach as a more coherent foundation for understanding and structuring utility regulation.

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KEYWORDS

utility regulation — regulatory theory — stakeholder theory — capture theory — rights-based approach

RESUMO

O artigo sustenta que a regulação de serviços públicos permanece elemento central e duradouro da governança contemporânea, apesar da liberalização e da ampliação da concorrência. As experiências do Reino Unido, da União Europeia, dos Estados Unidos e de países em processo de privatização demonstram a permanência do papel decisivo das instituições regulatórias. O autor critica dois modelos teóricos predominantes: o modelo bilateral ou contratual, incluindo a teoria da captura, e a teoria dos *stakeholders*, que posiciona a agência reguladora como núcleo de uma rede de interesses concorrentes. Nenhuma dessas abordagens explica adequadamente a complexidade da prática regulatória nem oferece base consistente para reformas. Defende-se, ao final, um retorno à teoria política e constitucional, com a adoção de uma abordagem baseada em direitos como fundamento mais sólido para compreender e estruturar a regulação de serviços públicos.

PALAVRAS-CHAVE

regulação de serviços públicos — teoria da regulação — teoria da captura — *stakeholders* — abordagem baseada em direitos

The Department of Trade and Industry Review of Utility Regulation marks a final recognition that the debate on such regulation is here to stay and will not disappear with the development of further competition or reforms of competition law.[1] Within the European Union a similar debate is taking place with the liberalisation of utility markets, especially telecommunications.[2]

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1 Department of Trade and Industry, *A Fair Deal for Consumers: Modernising the Framework for Utility Regulation* Cm 3898 (1998) (the Green Paper); *A Fair Deal for Consumers: The Response to Consultation* (London: Department of Trade and Industry, 1998).

2 For an introduction to these debates see C. Scott, *Competition and Coordination: Their Role in the Future of European Community Utilities Regulation* (London: Centre for the Study of Regulated Industries, 1995) and 'Changing Patterns of European Community Utilities Law and Policy: An Institutional Hypothesis' in J. Shaw and G. More (eds), *New Legal Dynamics of European*

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Utility regulation has also been controversial worldwide; in the United States, long regarded as its natural home, the relationship between deregulation and new regulatory techniques is now being reconsidered and many of the problems faced earlier in the UK about how to liberalise markets are being faced within a culture which has given a much greater role to identifiably regulatory institutions.[3] Finally, many other countries (for example in Central Europe) are, as the result of their privatisation programmes, having to grapple with the creation of regulatory institutions in cultures not necessarily sympathetic to the concept of relatively independent agencies.

In this article I will not attempt to deal in detail with reform proposals such as those in the Review, important as they are. Instead, I wish to suggest that the theoretical underpinnings implicit in much of the debate are unsatisfactory. In particular, two possible theoretical approaches to regulation are inadequate to bear the weight of understanding, or reforming, regulatory practice. These are a bilateral or contractual model of regulation in which the primary relationship is between regulator and regulated firm; a variant of this can be found in the economist's favourite critical model of 'capture theory'. The second approach (which indeed appears in the Review) is that of stakeholder theory with the regulatory agency seen as the centre of a web of relations in which the firm may be only one interest out of many, and this has something in common with the proceduralism popular in some legal writing. I shall attempt to suggest, using material primarily relating to UK utility regulation, that neither of these approaches can capture the complexity of the regulatory task, either for explanatory or prescriptive purposes. I shall conclude by speculating as to how a more successful approach to studying regulation can be developed by returning to political and constitutional theory and adopting a rights-based approach to regulation.

Union (Oxford: Clarendon Press, 1995). Particularly important questions have arisen with the establishment of new forms of regulatory bodies for telecommunications in France, Germany and Italy.

[3] See eg R. Pildes and C. Sunstein, 'Reinventing the Regulatory State' (1995) 62 *University of Chicago Law Review* 3.

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The complexity of regulation[4]

Many claims about regulation, both in practical policy and in economic theory, are misleading; regulation is a much more complex task than either would suggest. For example, in both, regulation has been seen as a temporary way of protecting customers of monopolies and thus 'holds the fort' until markets replace it with the free play of competition; like the state in Marxist theory, regulation then withers away.[5] Moreover, it has been argued that regulation can ideally be accomplished by the application of economic reasoning designed to achieve the single goal of maximising economic efficiency, mainly allocative efficiency.[6] This provides the legitimacy of the regulator through his or her economic expertise; what should be avoided, it is argued, is sullying this with social goals which are for elected governments, not unelected regulators. It does not mean that the regulatory task is necessarily a simple one, for the content of the economic theory applied is often highly controversial and the regulator still needs to ensure an adequate flow of information from the enterprise. Nevertheless, it does provide a potentially coherent set of principles within which the regulatory task can be addressed.

The withering away of the regulatory task and the central rationale of allocative efficiency have had little correspondence with the reality of utility regulation in the UK, in the EU or indeed in the USA. Regulation has shown little sign of withering away; rather it has become more complex as time has passed, as is recognised in the Review in its recognition of an indefinite future for some regulatory controls.[7] This would not in itself matter very much for the view of regulation outlined above in which efficiency maximisation is the predominant regulatory task; it would simply mean that providing market surrogate controls on monopoly would be permanent rather than temporary. However, regulation does not cease with the end of monopoly. One unexpected element in UK utility regulation is the extent to which the

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4 The arguments in this section are based on research published in much greater detail as T. Prosser, *Law and the Regulators* (Oxford: Clarendon Press, 1997).

5 The most influential statement of this view in relation to UK utility regulation was S. Littlechild, *Regulation of British Telecommunications' Profitability* (London: Department of Trade and Industry, 1984).

6 See C.D. Foster, *Privatization, Public Ownership and the Regulation of Natural Monopoly* (Oxford: Blackwell, 1992) esp ch 9.

7 Green Paper, n 1 above, para 2.8.

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regulators have taken on a new task, that of regulation for competition, for example through liberalising the domestic energy markets where the new markets have only been created through constant regulatory pressure in the face of foot-dragging by regulated companies. Moreover, market creation also involves creating a substructure of rules and other institutional and normative devices. Some of these are market-constitutive in the sense that we cannot envisage a functioning market without them; others are designed to create the proverbial level playing field, such as the continuing prohibitions of undue preference or undue discrimination by a dominant firm. Regulation thus has an important role in market creation; and it is not merely temporary, for these rules and other pro-competitive norms need continuing policing.[8] There are advantages in this being undertaken by specialist sectoral regulators which know their firms more intimately than could a general competition authority, especially where the operation of the competition authorities is attended by as many problems as it is in the UK; the reform of competition law currently in hand will not change the desirability of more specialised, sectoral regulators. As the Review has recognised, '[r]egulatory decisions do not become easier in competitive markets. If anything they become more difficult where more interests have to be weighted'.[9]

In principle once more the growth of regulation for competition does not contradict the view of regulation which insists on its economic rationale in the promotion of allocative efficiency; on this view, regulation for competition serves to promote and police the free markets which are the best way of securing such efficiency. However, across utility regulation it has proved impossible to separate economic approaches to regulation from the broader political and social framework. This can be illustrated vividly from the case of price control. Much of the hard work of the regulators here has been needed because price formulae were set far too generously by government on privatisation in order to permit a successful flotation of shares; this then permitted the recovery of excess profits after sale which in turn created a political outcry and forced regulators to take action both through tough periodic price reviews and through action outside the planned structure of the reviews such as encouragement of profit-sharing even outside the periodic

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8 See C. Shearing, 'A Constitutive Conception of Regulation' in P. Grabosky and J. Braithwaite (eds), *Business Regulation and Australia's Future* (Canberra: Australian Institute of Criminology, 1993).

9 Green Paper, n I above, para 7.13.

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review process.[10] Even apart from the political context, the process of price control has proved to be much less straightforward than originally envisaged. Setting price controls is more an art than a science, and has involved the evaluation of widely different arguments from the various parties involved, a far more procedurally complex process than anticipated.

Finally, it has proved impossible to avoid the intrusion, as some would see it, of social concerns in regulation. If we take regulation other than that of utilities, it is clearly the case that regulation has had an important social dimension. For example, regulation of broadcasting has long been concerned not just with economic goals but with the aim of diversity, ensuring a service which caters for a range of different tastes and interests, and this will not end with the development of channel profusion through digital transmission.[11] In the case of utilities, social regulation has normally, though not exclusively, taken the form of supporting universal service; for example in telecoms, '[t]he concept of universal service is based on the premise that telecommunications services now play such a fundamental role in our society that all people, whoever or wherever they are, must have access to a certain basic level of telecommunications facilities and services if they are to participate fully in modern society'.[12] This has influenced tariff setting through the encouragement of light user tariffs; it has also formed the basis for rules in the liberalised domestic energy markets to prevent 'cream-skimming' which would leave the poor with existing suppliers whilst the rich can benefit from competition and lower prices. Moreover, rather than representing isolated interventions in otherwise competitive markets certain social norms, for example those setting limits to 'cream-skimming', are actually constitutive of the markets themselves through defining their limits. Despite early expectations otherwise, utility services, like broadcasting, cannot be regarded as ordinary commodities but have an essential role in social cohesion and this has resulted in further tasks for the regulators, as is once more recognised in the Review.[13]

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[10] This perhaps appears most clearly in the case of the water industry, for which see Prosser, n 4 above, 127-132; it also applied to the other utilities and was the basis for the imposition of the 'windfall tax' on their activities by the incoming Labour Government.

[11] See D. Goldberg, T. Prosser and S. Verhulst (eds), *Regulating the Changing Media* (Oxford: Clarendon Press, 1998) esp chs I and 9.

[12] OFTEL, *Universal Telecommunication Services: Proposed Arrangements for Universal Service in the UK from 1997* (London: OFTEL, 1997); this will be discussed more fully towards the end of this article.

[13] Green Paper, n 1 above, ch 5.

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It is important to state at this point that avoiding giving social responsibilities to regulators appears to be supported by a powerful argument from democracy, an argument that has been made frequently by regulators themselves. This is that, whilst economic matters can be resolved through the regulators' expertise, social concerns involve matters of policy which can only be determined by Parliament through its democratic mandate; as the Director General of Water Services put it, '[s]ocial and sectoral considerations, which involve distributional issues and intervention in market processes, rightly involve politicians'.[14] A similar view appears in the Review; 'the Government, not regulators, should determine the social objectives of regulation' and as a result it proposes the issue of statutory guidance by Government to regulators in each sector.[15] This proposal is highly desirable as a means of providing a clearer framework within which regulators will work. Yet in the end the argument from democracy is unconvincing as a justification for a strict separation between economic and social objectives in the regulators' work. General elections are not determined by the level of British Telecom's light user tariff. At best, elections determine broad differences of approach which may include various assessments of the role of distribution in politics; they do not concern the details of implementation. This does indeed warrant the giving by government of policy guidance in general terms to regulators, though it remains to be seen how willing governments will be to develop hostages to fortune in this way; it should not be forgotten that any measures with significant financial implications (and this would include the most controversial such as energy levies) will not be included in guidance but in new, specific primary or secondary legislation.[16] The other meaning of the argument from democracy is that ministers are accountable to Parliament and so policies can be questioned more effectively and openly when they are made by ministers rather than by regulators. Yet even before the Scott report no one could have seriously dissented from the view that ministerial responsibility in this sense is a concept with minimal application to the real world of government and it neither guarantees the supply of information

[14] I. Byatt, *The Regulatory Scene* (Birmingham: OFWAT, 1996). This concern was also central to the reluctance of the Director General of Gas Supply to become involved in the promotion of energy efficiency schemes; see Environment Committee, *Energy Efficiency: The Role of OFGAS*, HC 328 (1993-94) and Prosser, n 4 above, 110-113.

[15] Green Paper, n 1 above, paras 2.13-18, 5.4; *Response to Consultation*, n 1 above, paras 10-14, 57-62.

[16] Green Paper, n 1 above, para 2.19; *Response to Consultation*, n 1 above, para 14.

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nor the availability of sanctions. In practice, the regulators have been far more open and accountable in their decision making than have ministers; '[i]n many ways [the Office of Telecommunications] provides a model from which ministerial government departments could learn'.[17]

The utility regulators thus have a variety of different tasks which cannot be reduced to any single logic, economic or otherwise. This then seems to require a pluralist approach to regulation; the regulators' practice, and indeed the legal duties which apply to them, reflect a variety of different rationales.[18] As a result they have come to resemble 'governments in miniature', a phrase originally employed about the early nineteenth-century commissions such as the Poor Law Commission.[19] This is not of course to maintain that the utility regulators' powers are in practical, or indeed legal, terms, as extensive as those of government departments; in many ways they are severely restricted.[20] Rather it is to suggest that no single logic can or should form a basis for their decision making, and they should not be seen as capable of implementing a mandate of simply applying government-issued guidance. Nor will this be fundamentally changed by the proposal in the Review to replace the regulators' somewhat incoherent current pattern of statutory duties with a single primary duty to exercise their functions in the manner they consider best calculated to protect the interests of consumers, to which other duties would be secondary.[21] There is no simple and universal answer to what is in the interests of consumers (nor indeed a single model of consumer); in many situations maximising competition will clearly be in consumers' interests, but in others this may not be possible, or limits to the free play of market through universal service provision may be more appropriate.

Of course this plurality of regulatory objectives immediately raises the problem of the regulators' democratic legitimacy. If regulators cannot be seen as implementing a mandate laid down by an elected government, one possible

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[17] C. Scott, C. Hall and C. Hood, 'Regulatory Space and Institutional Reform: The Case of Telecommunications' in Centre for the Study of Regulated Industries, *Regulatory Review 1997* (London: Centre for the Study of Regulated Industries, 1998) 231, 250.

[18] For the legal duties see Prosser, n 4 above, ch l; T. Prosser, 'Privatization, Regulation and Public Services' (1994) *Juridical Review* 3.

[19] The original source for this phrase is the *Law Magazine*, quoted in H. Arthurs, *'Without the Law': Administrative Justice and Legal Pluralism in Nineteenth-Century England* (Toronto: University of Toronto Press, 1985) 169.

[20] For a good statement of this point in relation to telecommunications see Scott, Hall and Hood, n 17 above.

[21] Green Paper, n I above, paras 3.3-9; *Response to Consultation*, n I above, para 16.

answer to this would be to concentrate on the procedures adopted and to see the only suitable reaction to such pluralism as being the development of procedures which ensure that as many different viewpoints as possible are made available to the regulator. Rather than gaining legitimacy through economic expertise, the regulator would do so through wide participation in decision making.[22] I shall return to the potential role and limits of proceduralism towards the end of this article and shall argue that it represents a necessary but not a sufficient step in achieving regulatory legitimacy. To stress the plural nature of the regulatory task is not enough. What is also necessary is to situate these characteristics of the regulators in more general theories of regulation and in turn to see what implications these theories have for models of how regulation works and how it should be designed. It seems to me that one can identify two radically different theories of the regulatory task, neither of them fully satisfactory in understanding the developments which I have outlined or in providing normative recommendations for reform.

The regulatory contract

The first theory or model is that which underlay the basic design of utility regulation in the UK; it is that of regulation as a form of bilateral contract between regulator and dominant regulated firm, the latter being in practice the enterprise being privatised after having benefited from a legal monopoly. The concept of such a contract seems to have underlain much of the institutional design adopted through creating a model in which the firm is privileged over other interests which may be affected by regulatory decisions.

For example, I mentioned above that many of the regulatory problems arose from the initial price formulae set by government, not by the regulators. These were set through bilateral negotiation between government and dominant company; other interests such as consumers were excluded. It is revealing to quote the first Director General of Gas Supply on the process: '[w]hen, in 1986, I asked if I could have a set of working papers on the construction of the formula I was told that certain forecasts had been made by industry experts and it had been, in the final analysis, a judgement call

[22] C. Scott, 'The Proceduralization of Telecommunications Law' (1998) 22 *Telecommunications Policy* 243.

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… when I pursued the issue to try to understand the general thrust of the judgement I was slightly disturbed to hear the value of "X" had been set "to get the company off to a good start"'.[23]

A further example of the privileging of the firm through the adoption of an underlying bilateral contractual model of regulation can be found in the all-important procedures for modifying the licences under which the regulated firms operate; it is these procedures which are used to modify price control formulae and to incorporate new conditions such as those limiting disconnections and, more recently, relating to fair trading. The details vary from case to case, but in outline an amendment can be made if the firm agrees, subject to very limited procedures for publication and the receipt of comments by the regulator when firm proposals are agreed.[24] If the firm does not agree, the regulator can make a reference to the Monopolies and Mergers Commission and will then be in a position to impose a modification taking into account the Commission's report. The latter cumbersome procedure has been used relatively rarely, though its use has increased a little recently, most notably with the recent reference relating to British Gas' transportation and storage charges.[25] The point is that, as a matter of law, the licence can be amended if the firm agrees, irrespective of the views of others affected. Moreover, the 'appeal right' of a Monopolies and Mergers Commission reference, though made at the initiative of the regulator, in practice will only be exercised where the regulated firm will not accept a proposed licence modification and not, for example, at the instance of a consumer group which objects to a change agreed between firm and regulator.[26] It has to be said immediately that the strict legal position is misleading as all the regulators have in practice adopted means to ensure early consultation of consumers and others in the process of licence amendment, with a considerable degree of success in most

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[23] J. MacKinnon, 'Conference on Regulatory Reform' (1993) 4 *Utilities Law Review* 119, 119-120. For a fuller consideration of the relationship between the privatisation process and regulation see J. Kay and Z. Silberston, 'The New Industrial Policy: Privatisation and Competition' (1984 Spring) *Midland Bank Review* 8.

[24] The relevant provisions are the Telecommunications Act 1984 ss 12-15; Gas Act 1986 ss 23-27; Electricity Act 1989 ss 11-14; Water Industry Act 1991 ss 13-16; Railways Act 1993 ss 12-15.

[25] Monopolies and Mergers Commission, *BG pie. A Report Under the Gas Act 1986 on the Restriction of Prices for Gas Transportation and Storage Services* (London: Monopolies and Mergers Commission, 1997).

[26] For a similar criticism of the license modification procedures see Scott, Hall and Hood, n 17 above, 241.

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cases.[27] My point is not that the practice of the regulators has been such as to privilege the firm; rather that the legal basis on which the regulators operate is inadequate to cope with the complexity of this regulatory practice. Nor do the Review proposals change this, concentrating on relatively minor reforms to the Monopolies and Mergers Commission procedure rather than changing the scope of its operation through, for example, creating rights of third-party appeal.[28]

Finally, the stress on regulation as a bilateral relationship between regulator and dominant firm has meant that it is unsuited to the new environment of multi-enterprise competition between several firms in parts of the telecoms and energy markets. I suggested earlier that the development of this environment has not meant that regulation has withered away but that a new type of regulation for competition has emerged instead. This is the reason why the Director General of Telecommunications found it necessary to introduce fair trading conditions which proved highly controversial and to make their acceptance by BT a condition of introducing a revised version of the pricing formula.[29] In particular, the patchy coverage of the original 'behaviour specific' licence conditions and the cumbersome procedure for plugging gaps through licence modifications, together with the lack of interdict or damages as remedies for injured competitors, limited the ability of the regulator to respond rapidly; a problem which has been even greater, incidentally, in the bus sector where the ordinary competition authorities were used. It is however questionable whether even after the new conditions an unrevised Telecommunications Act provides an adequate enforcement base for OFTEL to act as a real competition authority.[30] In the case of gas, some limited changes were introduced to prepare for a competitive domestic market by the Gas Act 1995, but these fell far short of a general recasting of the regulator's role to cope with the new environment.[31]

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[27] For a detailed description of the procedures see Prosser, n 4 above, 83-85, 113-115, 144-147, 177-178, 198-199.

[28] Green Paper, n 1 above, paras. 7.47-79; *Response to Consultation*, n 1 above, paras. 91-4; cf the new arrangements in general competition law: Competition Act 1998 s47.

[29] OFTEL, *Pricing of Telecommunications Services from 1997: OFTEL's Proposals for Price Control and Fair Trading* (London: OFTEL, 1996). The fair trading conditions successfully survived a challenge by judicial review; see *R* v *Director General of Telecommunications, ex p British Telecommunications pie,* CO *3596196,* QBD.

[30] C. Scott, 'Deregulation of BT's Pricing and the New Fair Trading Requirements' (1997) 8 *Utilities Law Review* 120.

[31] There are also tentative proposals for extending collective licence modification procedures in the Review: Green Paper; n I above, paras 7.70-72; *Response to Consultation*, n I above, para 95,

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The legal basis for regulation (though not necessarily regulatory practice) was thus created on the assumption that the primary regulatory relationship was with a single firm. Not only did this afford little room for other interests such as consumer groups, it assumed that the sole task of regulators would remain that of policing the actions of a single monopoly provider rather than policing increasingly competitive, multi-enterprise markets. A further step which this model has facilitated is to conceive of the relationship between regulator and dominant firm as a form of bilateral contract, and so to preclude amendments to the regulatory arrangements which increase the burden on firms. Thus this concept of a regulatory contract has been used as a basis for criticism of regulators and government for what has been seen as over-demanding regulation. For example, Cento Veljanovski has claimed that

> there was a feeling that the prospectus would provide a binding commitment or bargain between Government and shareholders … It was envisaged that [regulation] would operate with a light touch, based on a number of simple and stable rules which would be revised at set intervals … If one group develops legitimate expectations which are disappointed or there is continuing uncertainty about what are legitimate expectations then it becomes impossible for business to plan with confidence and regulators' actions amount to expropriation of shareholder wealth.[32]

This model has not proved attractive to the regulators themselves; to quote the Director General of Water Services, '[t]here is some uncertainty about what constitutes a regulatory contract. I am not entirely happy with the word. … Such a contract cannot be made for as long a period as five years'.[33] It is easy to defend regulators against the critique implied by the quotation from Veljanovski; for example, governmental claims could also form the basis for 'legitimate expectations' by consumers and employees who were both promised a better deal after privatisation, and legitimate expectations does not work in law to create substantive privileges of this kind.[34] Rather than a regulatory contract having been broken by the regulators, the examples I

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and Department of Trade and Industry, *Licence Modification Procedure: Proposed Changes to the Telecommunications Act 1984* (London: Department of Trade and Industry, 1998).

[32] C. Veljanovski, *The Future of Industry Regulation in the UK* (London: European Policy Forum, 1993) 59-60.

[33] I. Byatt, *Speech at European Policy Forum on Tuesday 7 May 1996* (Birmingham: OFWAT, 1996) 4-5.

[34] See eg *R* v *Secretary of State for the Home Department, ex parte Hargreaves* [1997] 1 WLR 906, and C. Forsyth, '*Wednesbury* Protection of Substantive Legitimate Expectations' [1997] *Public Law* 375.

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have given suggest that there is a tension between the actual behaviour of the regulators and the underlying legal model on which their powers are based.

Capture theory and public choice

The model of a bilateral regulatory relationship has, then, been used both as a model for the legal regime adopted and as a source of criticism of regulatory decision-making. It can also be seen in one version of the highly influential theory of regulatory capture which has underlain much analysis of regulation within economics and elsewhere.[35] This proposes that the behaviour of regulators can be predicted from an analysis of the *a priori* interests of regulators and firms and that the result is inevitably that regulation will be established to protect the industry or that the regulator will be captured by the regulated industry. Regulators operate in political markets in which the regulated firm will have most to lose from the regulator's actions therefore and will have the greatest incentive to take action to influence it. As a result it will be able to bid up in the political marketplace by, for example, offering future jobs to regulatory staff, limiting the information available to the regulator or, in extreme cases, by bribery. An influential version is that of the life cycle theory which suggests that a regulator starts off vigorously but then public interest is diverted to other subjects leaving the regulator open to capture.[36] There is a vast body of literature on capture theory and important differences within it; for example, it originated in the Chicago school which may see capture as economically efficient; it cannot be otherwise if it happens as the parties are all assumed to be rational efficiency maximisers and so it affects only distribution of the benefits.[37] Other commentators such as Posner have seen capture as reducing economic efficiency through maintaining barriers to entry and as being costly in itself.[38] The most important point to be made here

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[35] The literature of capture theory is immense and I can only hint at some of its themes here. For useful introductory surveys see Foster, n 6 above, ch 11 and A. Ogus, *Regulation: Legal Form and Economic Theory* (Oxford: Clarendon Press, 1994) ch 6.

[36] The seminal statement of capture theory is G. Stigler, 'The Theory of Economic Regulation' (1971) 2(1) *Bell Journal of Economics and Management Science* 1, concentrating mainly on the establishment of regulation to benefit regulated firms. For an early statement of life-cycle theory see M. Bernstein, *Regulating Business by Independent Commission* (Princeton: Princeton University Press, 1955).

[37] See Foster, n 6 above, 372-373.

[38] See *ibid* and eg R. Posner, 'Theories of Economic Regulation' (1974) *5 Bell Journal of Economics and Management Science* 335-358.

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is however that this early version of capture theory, and indeed most uses of the approach in popular discussion of regulation, concentrates on the bilateral relationship between the regulator and the dominant regulated firm, or at most a small and well organised group of very similar firms. Thus as Stigler put it in the seminal work cited above, '[a] central thesis of this paper is that, as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit'.[39] If the industry sector consists of more than a single firm the former is assumed to have a single, organisable set of interests which mean that it can be treated as if it were a single firm. This version of capture theory 'singles out a particular interest group—the regulated firms—as prevailing in the struggle to influence legislation, and it predicts a regular sequence, in which the original purposes of a regulatory programme are later thwarted through the efforts of the interest group'.[40]

The approach I have adopted, by contrast, sees the regulator as in the middle of a web of relations, none of which can be assumed to have particular priority and which may well be in fundamental conflict.[41] Therefore capture cannot be predicted as a matter of *a priori* principle. Where regulation is of a multi-enterprise sector it is unlikely that it will be possible to speak of a single industry interest, let alone adequately consider the roles of the workforce or consumers, who may themselves have conflicting interests, for example between domestic and business consumers. This broadening can have both optimistic and pessimistic implications. The optimistic assumption is that of traditional pluralism in that if there are a number of interests involved, and they all have access to regulatory procedures, the interests may balance out and so the more general public interest in the end prevails.[42] The pessimistic implication is that capture may take place by other interests apart from the firm or the industry. On the evidence I gave earlier it is certainly possible to suggest that the early stages of the regulatory process were subject to governmental capture rather than capture by the firm, not in the sense that the regulators were pressurised by ministers but that major decisions, in particular the all-important initial price formulae, were determined directly by

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[39] n 36 above, 1.

[40] Posner, n 38 above, 341-342.

[41] For an elegant statement of a similar theme see J.Q. Wilson, *The Politics of Regulation* (New York: Basic Books, 1980) ch 10; as he puts it, '[a] single-explanation theory of regulatory politics is about as helpful as a single explanation of politics generally, or of disease' (393).

[42] For a useful summary of the pluralist literature on this point see P. Dunleavy, *Democracy, Bureaucracy and Public Choice* (Hemel Hempstead: Harvester Wheatsheaf, 1991) 14-27.

government to achieve the political objective of successful privatisation. This is not to say, of course, that industry capture cannot happen; the relationship between producers and the Ministry of Agriculture illustrates powerfully that it can.[43] Instead, I am suggesting that to assume that industry capture is the only, or *ex hypothesis* the most likely form of regulatory evolution, is a drastic oversimplification.

Another approach is apparent in the work of a number of writers from within political science rather than economics. One of the best-known examples is the concept of 'regulatory space' developed by Hancher and Moran.[44] They reject capture theory on the grounds that it assumes a false dichotomy between state and society:

> Economic regulation under advanced capitalism is therefore best conceived as an activity occurring in economies where the public and private are characteristically mixed, where the dominant actors are powerful and sophisticated organizations, and where the biggest firms have taken on many of the features of governing institutions. … In this world the language of regulatory capture is largely devoid of meaning. … different institutions have come to inhabit a common regulatory space. The critical question for the analyst of the European regulatory scene is not to assume 'capture', but rather to understand the nature of this shared space: the rules of admission, the relations between occupants, and the variations introduced by differences in markets and issue arenas.[45]

This work offers an extremely fruitful agenda for research and is far more realistic than an approach which concentrates on bilateral relations between regulator and firm. However, it does carry a danger of ending up with a sort of a-theoretical pluralism in which predictions are impossible and every interaction is reduced to a particular, unique instance. On this basis, prediction of regulatory behaviour would be impossible. Perhaps even more importantly we could not make normative decisions about how regulation should interact with its environment or how to make it legitimate, except perhaps by attempting to ensure that all legitimate interests are represented in the regulatory process, an approach which, as I shall suggest below, has

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43 G. Cannon, *The Politics of Food* (London: Century Hutchinson, 1987).

44 L. Hancher and M. Moran, 'Organizing Regulatory Space' in Hancher and Moran (eds), *Capitalism, Culture and Economic Regulation* (Oxford: Clarendon Press, 1989).

45 *ibid* 276. For an application of these ideas see Scott, Hall and Hood, n 17 above, and A. Melville, 'Power, Strategy and Games: Economic Regulation of a Privatized Utility' (1994) 72 *Public Administration* 385.

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difficulties of its own. One way of avoiding these problems is to develop capture theory so that it does not necessarily privilege explanations based on interaction between the regulator and the firm. This has been a theme of importance within capture theory.[46] Indeed, it has produced a distinctive 'Virginian' version of capture theory which can be subsumed within the influential school of public choice.[47] In brief what this work does is to treat politics as a form of marketplace in which all actors behave rationally to maximise utility. Voters use their voting power to extract benefits from the democratic process; politicians use their power to maximise their own wealth or other utility through 'log rolling' and so on; bureaucrats maximise the size of their budgets. This approach would appear to have the advantage of preserving the conception of regulation as a pluralistic enterprise with a number of different purposes and open to influence from a range of interests. However, it raises fresh problems which limit its usefulness.[48] Firstly, if the theory is simply saying that wealth maximisation is one element in politics this is neither new nor particularly helpful; it is familiar from muckraking journalism let alone more elevated sources, and does not help in analysing *where and in which circumstances* wealth maximisation can be used successfully to predict regulatory behaviour. If it is saying that wealth maximisation is the *only* valid explanation of political behaviour (and to have predictive power it presumably must be saying this) it is palpably false; prestige, an easy life and even altruism and public service are well documented sociologically as parts of political life.[49] A further possible response is to expand the definition of utility to include non-monetary utility such as prestige, 'an easy life' and 'feeling good' rather than maximisation of material wealth, but if everything can count as utility all predictive value is taken away from the theory and we are back with the sort of pluralist contingency this theory was designed to overcome. As Foster puts it:

> though this theory involves a gain in realism it loses in predictive power. The proponents of such a theory easily find themselves in a situation where, whatever the regulatory outcome, it can always be rationalized as the

[46] See in particular S. Peltzmann, 'Towards a More General Theory of Regulation' (1976) 19 *Journal of Law and Economics* 211 and Posner, n 38 above.

[47] For a summary of the 'Virginia' approach see Foster, n 6 above, 384-388; for an excellent critique of the enormous public choice literature see Dunleavy, n 42 above.

[48] cf Wilson, n 41 above, 361-363.

[49] For a sustained attack on public choice theory on this and other grounds, see M. Kelman, 'On Democracy-Bashing: A Skeptical Look at the Theoretical and "Empirical" Practice of the Public Choice Movement' (1988) 74 *Virginia Law Review* 199.

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> achievement of a political equilibrium between the various interests … Because one does not know what weight to give in each case to money, votes, ideology and other factors, some of which cannot be measured at all, one has no measures of comparative efficiency.[50]

A more useful revisionist approach to capture theory has concentrated on the complexity of the institutional and political context in which regulation may take place, and in this sense has much in common with the regulatory space approach.[51] Thus for example Levine and Forrence have stressed the limitations on capture which result from issues being moved onto the public agenda, whilst Makkai and Braithwaite emphasise multidimensional pressures towards different types of capture which can be countered by, for example, granting third party participation rights. This approach is weak in asserting a base for substantive normative principles of regulation.[52] However, it is valuable in providing the basis for a procedural approach to regulation. This leads us to a different approach which I shall now discuss before asking whether it is possible to move beyond proceduralism towards substantive principle.

Stakeholder theory

A quite different approach to understanding regulation is now becoming fashion-able in the form of stakeholder theory. This would appear to offer a way out of the problems I have just raised both predictively through identifying the key interests which may influence regulation and normatively through suggesting the interests which should participate in the regulatory process. It would seem to present a possible solution to the criticisms of capture theory that I have made above as, rather than seeing regulation as a bilateral relationship between regulator and firm, regulation encompasses a network of relations involving the dominant firm, its competitors, its consumers and others such as employees and suppliers. Indeed, a commentator on utility

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[50] n 6 above, 387.

[51] See notably M. Levine and J. Forrence, 'Regulatory Capture, Public Interest and the Public Agenda: Toward a Synthesis' (1990) 6 *Journal of Law, Economics and Organization* 167, and T. Makkai and J. Braithwaite, 'In and Out of the Revolving Door: Making Sense of Regulatory Capture' (1995) 12 *Journal of Public Policy* 61.

[52] See eg Levine and Forrence *ibid* 181-182 where the substantive analysis of policies is left to 'a broader philosophical debate' or to notional ratification by an informed polity.

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regulation under the aegis of the influential Institute for Public Policy Research has explicitly advocated 'a stakeholder approach to regulation' in which government sets a more explicit framework for the regulators, one which will reflect both the national interest and those of different stakeholder groups.[53] Thus regulators themselves 'should pay explicit attention to the interests of different stakeholder groups and adjust their regulatory instruments to ensure that outcomes are not inconsistent with a desirable balance between them'.[54] Government should also play a part through setting broad sectoral policies in mission statements agreed with regulators. The relevant stakeholders are to be business and residential customers, shareholders, utility managers, market entrants, suppliers and other companies dependent on utility industries, and employees in the affected sectors.[55] Significantly, there has been some regulatory support for this view.[56] Moreover, the Review also shows the influence of this approach; 'if regulation is to win long-term acceptance, and thus provide a stable framework for business, it must be fair, and seen to be fair, by all those with a stake in the utilities'.[57] The influence of stakeholder theory also appears in the frequent references to maintaining a fair balance between consumer and shareholder, the role of social and environmental guidance and increasing transparency.[58]

A stakeholder approach also seems to provide the basis for an alternative conception to the bilateral regulatory contract approach which I have seen as at the heart of the problems. Thus there have been moves in areas of corporate governance and company law which have conceived of corporate governance as analogous to politics, both in the sense that it offers indirect forms of interest representation within the firm, and in the sense that relations are not seen as those based on bilateral contracts but on relational contracts establishing long-term relationships between a number of parties, subject to their own procedures for change, or on a nexus of contracts between them.[59]

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53 D. Souter, 'A Stakeholder Approach to Regulation' in D. Corry, D. Souter and M. Waterson, *Regulating Our Utilities* (London: Institute for Public Policy Research, 1995).

54 *ibid* 45.

55 *ibid* 35-53.

56 I. Byatt, n 33 above, 6.

57 Green Paper, n 1 above, para 1.5.

58 See eg Green Paper, n I above, paras. 2.9, 5.1-2, 7.18; *Response to Consultation*, n 1 above, paras 6, 96.

59 R. Drury, 'The Relative Nature of a Shareholder's Right to Enforce the Company Contract' (1986) 45 *Cambridge Law Journal* 219. See also the seminal work in this area, M. Stokes, 'Company Law and Legal Theory' in W. Twining (ed), *Common Law and Legal Theory* (Oxford: Blackwell, 1986) 155.

This does not necessarily imply a stakeholder approach as the concern may only be with the relations between the company and its members and between the members themselves; however it does show that even a contractual model may be far more complex than the bilateral one criticised above. A further step is to make an analogy with public law based on the social importance and power of the modern company; to quote Stokes, 'the large company tends to collapse the distinction between private and public power. The company can thus plausibly be viewed as a miniature state. All those affected by its decisions are citizens of that state and should therefore be involved in making those decisions'.[60] As a result a stakeholder approach is necessary to open up accountability to the wide range of interests affected.[61]

If this opening up of the bilateral relationship can be valid when assessing internal controls in the firm, surely it can be even more so in understanding the basis of external controls in the form of regulation? Indeed, there would seem to be two reasons for suggesting that it would be even more valid. Firstly, the essential nature of the services provided by utilities means that their decisions affect particularly important social interests; I shall deal with the question of how we identify those interests at the end of this article. Secondly, one forceful critique of the stakeholder approach, made both by right and left, is that it underplays the role of the market environment in which the enterprise operates. Although enterprises may engage in window dressing about responsiveness to stakeholders, in the end the market imperative to maximise profit will always prevail. Thus '[i]n reality, the dynamics of capitalist society are such that it is ultimately presided over not by people but by the market: neither the capitalist entrepreneur nor the paid manager *controls* their own enterprises, let alone the economy as a whole, except in a limited sense'.[62] This is questionable in itself.[63] Even if it were to be accepted, however, as I outlined at the beginning of this article, the operation of the utility regulators

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60 Stokes, *ibid* 178.

61 See (from an enormous literature) J. Kay and A. Silberston, 'Corporate Governance' (1995) 153 *National Institute Economic Review* 84 and for some reservations, P. Ireland, 'Corporate Governance, Stakeholding, and the Company: Towards a Less Degenerate Capitalism' (1996) 23 *Journal of Law and Society* 287, with a reply by D. Campbell, 'Towards a Less Irrelevant Socialism: Stakeholding as a "Reform" of the Capitalist Economy' (1997) 24 *Journal of Law and Society* 65. For an attempt to apply a stakeholder approach see Royal Society of Arts, *Tomorrow's Company: The Role of Business in a Changing World* (London: Royal Society of Arts, 1995).

62 Ireland, *ibid* 305 (emphasis retained). For a critique from the right on similar grounds see eg M. Friedmann, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962).

63 See Campbell, n 6 I above.

cannot be seen as constrained to mimic markets; other rationales such as some types of social regulation inevitably play a part in their decisions. This has been so even in areas such as the development of competition in domestic telecommunications and energy, which are at the heart of their economic tasks. Moreover, the statutory duties which apply to the regulators cannot themselves be seen as implementing any single logic of maximising profit for regulated companies, nor will the changes proposed in the Review do so.[64] Thus, even if an individual firm is constrained by a fundamental market logic (and this is by no means as simple as it may sound), a regulator need not be.

An apparent strength in the stakeholder approach is that it is not merely descriptive but has a strong normative dimension; not only do stakeholders have interests, but there is a moral obligation on companies or regulators to take those interests into account. This could provide a framework for assessing the legitimacy of regulatory decisions and so fill the gap in this legitimacy identified above. There may be individual reforms such as opening appeal rights to interests other than the regulated firm which we can make uncontroversially through applying stakeholder theory (though this is not proposed in the Review).[65] However, there is a serious problem in utilising stakeholder theory as a general theory for the prediction of regulatory behaviour and for making normative decisions of regulatory design. This was noted by the Director General of Water Services after cautious commendation of the stakeholder approach; '[t]he stakeholder approach does not tell us what the right balancing of interests is'.[66] Thus, whilst advocating opening up regulation to a wider range of interests, stakeholder theory provides no criteria for determining which interests are to count and how much they are to count. This depends on some higher, unarticulated theory or set of political values. A controversial example would be that of the workforce. So far, regulatory decision making has played minimal attention to the interests of the workforce; indeed, the interest of employees is the one interest conspicuously missing from those reflected in the statutory duties of regulators, and again there is no suggestion for change in the Review.[67] This need not always be so: earlier regulation gives us the example of the 'basic price

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64 Prosser, n 4 above, ch I; cf J. Ernst, *Whose Utility? The Social Impact of Public Utility Privatization and Regulation in Britain* (Buckingham: Open University Press, I 994) 60.

65 For an example see Prosser, n 4 above, 301-304.

66 Byatt, n 33 above, 6.

67 cf the duty of company directors to consider the interests of employees in Companies Act 1985, s 309.

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system' of price control used for the gas industry from 1920 in which extra dividends payable in certain circumstances had to be matched by equivalent payments to employees through co-partnership schemes or bonuses.[68] We could argue that the workforce should have a role in the regulatory process for the public utilities, but why? Souter in the work cited above bases the involvement of employees as stakeholders on the fact that 'they have much to lose if things go wrong' and that 'competition and price regulation have also put considerable pressure on utility managers to cut costs, particularly labour costs'.[69] This appears compelling, but it could also be applied to, for example, the employees of supplier and competitor firms; where do we draw the line between stakeholders and non-stakeholders? More seriously, this approach gives us no indication of the relative weight to be attached to different stakeholder interests; it is hardly inconceivable that employee and consumer interests will be in direct conflict and simply to point to both as stakeholders hardly takes us any further in resolving that conflict. Finally, there is something to be said for the argument that proliferating the number of stakeholders will result in a confusing melange of conflicting objectives with none adequate to offer realistic guidance; as has been suggested in the context of corporate governance

> 'Making bosses accountable to many stakeholders might make them accountable to none, as there would be no clear yardstick for judging their performance' … This problem is familiar from Britain's experience with nationalised industries, where the multiplicity of goals led to confusion between the concerns of government and those of industry.[70]

The easiest way out of the dilemma of who is to count as a stakeholder would be to recognise as stakeholders those whose interests are affected. This merely moves the difficulties one step back, however, for we need to determine which interests are worth protecting and to develop some order of ranking between them. Even in corporate governance there is still considerable controversy over which interests count as stakeholder interests, even to the extent of disagreement on whether shareholders themselves have a central

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[68] *The Gas Industry: Report of a Committee of Enquiry,* Cmd 6699 (1945) paras 45-46.

[69] n 53 above, 43.

[70] Kay and Silberston, n 61 above, 93. The quotation is from M. Bishop, 'A Survey of Corporate Governance' (1994) 330 *The Economist* 53. For detailed discussion of the nationalised industries problem see Foster, n 6 above, ch 3.

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role.[71] Moreover, there is also no consensus on the basic objectives which stakeholding is to promote; are they concerned essentially with assisting profit maximisation or partially replacing it with broader social concerns?[72] Such difficulties are likely to be even greater in regulation where there is no central organising nexus for different interests like that of the company. Thus stakeholder theory on its own does not take us beyond regulatory pluralism; it needs supplementing by other theory which might help in identifying and ranking interests.

Proceduralism in regulation

The conclusion that I have just drawn may seem to be too harsh. One advantage of stakeholder theory may be alert us to the need for participative procedures in regulation. Thus even if we cannot precisely identify stakeholders or rank the interests they represent, at least we can be open to the need to ensure that the regulator has access to information from as wide a range of interests as possible in reaching decisions. This is in contrast to capture theory which has generally been pessimistic about the role of participative procedures; they are seen as inevitably leading to domination by the regulated industry as the only participant with the resources to ensure that its own view prevails through them at the expense of efficiency-maximisation or of the public interest. For example, in the pioneering work cited above, Stigler suggests that

> the procedural delays required of public processes are costly. The delays which are dictated by both law and bureaucratic thoughts of self-survival can be large … Finally, the political process automatically admits powerful outsiders to the industry's councils. It is well known that the allocation of television channels amongst communities does not maximise industry revenue but reflects pressures to serve many smaller communities. The abandonment of an unprofitable rail line is an even more notorious area of outsider participation.[73]

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[71] Kay and Silberston, n 61 above.
[72] See eg Ireland, n 61 above, esp 300-306, 310-315.
[73] Stigler, n 36 above, 6. The work of Levine and Forrence and of Makkai and Braithwaite (n 51 above) is an important exception to this hostility to participative regulation.

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Rather than seeing the involvement of community interests as 'notorious', stakeholder theory would see it as highly desirable.[74] This emphasis on the virtues of participative procedures also has the advantage of being close to the actual practice of utility regulators in the UK, and of course in the United States. In the former, the procedures adopted for the making of key decisions have generally been much more open to a range of interests than the law requires, whereas in the latter there is an enormous body of administrative law designed precisely to permit such interest representation.[75]

The limits of substantive legal regulation have become the subject of a large body of literature recently. Of particular importance has been that drawing on the theory of autopoiesis, theory which is highly complex and which cannot be rehearsed in full in this article but which has regulatory implications which should be examined here.[76] One starting point of the theory is closely related to many current critiques of the utility regulators; as King has put it,

> [t]here have proved to be a number of problems … with the Utopian vision of law as an effective regulator of social behaviour. Not least of these was the growing evidence of law's failure to fulfill the high hopes that had been expected of it. Attempts to regulate social systems through law often seemed to work effectively for a short time and then would produce consequences which were unanticipated by legislators and would-be reformers.[77]

This is largely attributable to the fragmentation of modern societies into differentiated functional systems and sub-systems, including law, politics and the economy. These sub-systems are cognitively open but normatively closed;

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[74] See I. Ayres and J. Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford: Oxford University Press, 1992) ch 3.

[75] For the UK see Prosser, n 4 above, 83-86, 113-115, 144-147, 177-178, 198-199, 259-266, 296-297; for analysis and critique of the US 'interest representation' model see R. Stewart, 'The Reformation of American Administrative Law' (1975) 88 *Harvard Law Review* 1669-1813.

[76] For a very clear introduction to autopoiesis see M. King, 'The Truth about Autopoiesis' (I 993) 20

Journal of Law and Society 218; for an earlier example with some direct relevance to regulation see

G. Teubner, 'Substantive and Reflexive Elements in Modern Law' (1983) 17 *Law and Society Review* 239, and for later development eg G. Teubner, 'Juridification: Concepts, Aspects, Limits, Solutions' in G. Teubner (ed), *Juridification of the Social Spheres* (Berlin: de Gruyter, 1987) and his *Law as an Autopoietic System* (Oxford: Blackwell, 1993). For a direct application to regulatory concerns see J. Black, 'Constitutionalising Self-Regulation' (1996) 59 MLR 24. The literature is once again enormous; for an interesting criticism see J. Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy* (Cambridge: Polity Press 1996) 52-56.

[77] King, *ibid* 222 (footnote omitted).

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this means that, to quote King once more, '[t]he normative communications of other systems cannot simply be reproduced by law as legal communication. They first have to be reconstructed as law if they are to become accepted as law, and this reconstruction process may well give rise to unforeseen distortions and reductions to the meaning of the original communications as they were formulated in the political or economic systems'.[78] Similar communication problems also occur in the attempted use of law to influence the behaviour of economic systems. The problem is illustrated in Teubner's discussion of price control. If law imposes a price freeze:

> [t]his is normally understood as a clear case of the law intervening directly in the economy. From the point of view of autopoiesis, however, it is merely an act of observation … Through the device of the price-control norm, the law is merely observing its own operations, imagining all the while that the economy functions in such and such a way … From the moment it is promulgated to the moment it is implemented, our price control consists solely in cognitive and normative operations which are played out within the law and which cannot be transferred to the economy … this procedure does not lead from legal conceptions of the economy to the reality of the economic system itself.[79]

This would appear very apposite to analysis of the problems of regulators attempting to control excess profits through price control, or to ensure that the water companies and Railtrack properly use profits for investment rather than passing it on in dividends.

Autopoiesis, then, posits the existence of severe restrictions on the direct regulatory capacities of law. It is worth noting, incidentally, in the context of this article, that it also posits serious restrictions on the ability of law to implement the logic of the economic system; the economics of law model 'leads to a systematic failure to note the capacity of the legal system to select economic input'.[80] As regards law's regulatory limitations, growing juridification can lead to Teubner's 'regulatory trilemma' in which law is either ignored by other systems, or destroys those systems' traditional and appropriate norms of behaviour, or is itself disintegrated by the pressures imposed on it by other systems.[81]

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78 *ibid* 227; for a summary see also Teubner, n 76 above (I 993) 69-71.
79 Teubner, *ibid* 77-79.
80 *ibid* 57.
81 Teubner, n 76 above (1987) esp 19-27; Black, n 76 above, 47.

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Is the implication of this analysis an end to law as a regulatory device, an end to intervention by public authorities in economic systems, indeed an end to regulation? This is not the solution proposed. Rather than abandoning law, the proposal is for 'reflexive law'. It has some characteristics in common with the stakeholder approach discussed above; in an early statement of the theme it was described in the context of contract law as follows:

> Reflexive law … seeks to structure bargaining relations so as to equalize bargaining power, and it attempts to subject contracting parties to mechanisms of 'public responsibility' that are designed to ensure that bargaining processes will take account of various externalities. However, within the limits of the arena that has been so structured, the parties are free to strike whatever bargains they will. Reflexive law affects the quality of outcomes without determining the agreements that will be reached. Unlike formal law, it does not take prior distributions as given. Unlike substantive law, it does not hold that certain contractual outcomes are desirable.[82]

Reflexive law thus represents a new proceduralism; rather than determining outcomes directly, it fosters the development of structures for reflexion within other social subsystems, including through compensation for inequalities in power and information. Thus 'instead of directly regulating social behaviour, law confines itself to the regulation of organization, procedures and the redistribution of competences'.[83]

Once more we see strong echoes of some of the issues concerning UK utilities regulation here; most notably in the greater proceduralisation of regulation through the incorporation of interest groups and in growing interest in 'self regulation' or 'enforced self regulation' as a regulatory strategy.[84] Two reservations have however to be entered in relation to the use of this work as the sole approach to analysis of this regulation. The first is that it is doubtful to what extent the process of juridification has advanced in this area of UK administration. It is certainly true that judicial review and other forms of legal challenge have become more common.[85] Nevertheless, in some

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[82] Teubner, n 76 above (1983) 256 (footnote omitted).

[83] Teubner, n 76 above (1987) 34; see also Teubner, n 76 above, (1983) 270, 275, 277 and Black, n 76 above, 44, 46.

[84] See Black, n 76 above, and Ayres and Braithwaite, n 74 above, ch 4.

[85] C. Scott, 'The Juridification of Regulatory Relations in the UK Utilities Sectors', in J. Black, P. Muchlinski and P. Walker (eds), *Commercial Regulation and Judicial Review* (Oxford: Hart Publishing, 1998). A key decision was *Mercury Communications Limited* v *Director General of Telecommunications* [1996] I WLR 48.

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areas of regulation at least the tests applied by the courts have been notably open textured, leaving a considerable power to regulators to set priorities and balance competing interests.[86] Moreover, the legislation also permits considerable regulatory discretion, even to the extent of largely leaving the ranking of regulators' basic objectives to the regulators themselves; the re-ordering of statutory duties proposed in the Review will not do much to change this.[87] Thus the excesses of detailed substantive prescription by law have been largely avoided in the utility regulation sector, especially compared to some areas of local government where juridification has been used as a political tool in battles between central government and local authorities.[88] Moreover, juridification means more than an increase in the number of legal rules. It implies that regulatory law is used in which, rather than general rules, particularistic requirements are made of conduct to achieve substantive social ends; in Weberian terms, law is materialised.[89] Yet, as Scott has pointed out, at least in the field of telecommunications current moves seem to be towards dematerialisation through the replacement of particularist norms by general norms, reflecting both the development of multi-enterprise markets and the role of European requirements.[90] It would thus, so far at least, be an exaggeration to talk of the juridification of utilities regulation showing that substantive regulation through law is unworkable. Examples of difficulties of regulatory implementation in such areas as price control have certainly existed; however, there may be more contingent explanations for this, in particular the setting of the first generation of price controls over-generously for the companies by Government in order to assist the privatisation process, and the expectation of over-long periods between periodic price reviews. It is certainly possible to point to areas in which substantive regulation has been at least partially successful, for example in the setting of service standards and the decline of disconnection rates. Even the later generations of price controls are now more demanding and are certainly strongly resisted by regulated companies. In this respect there is a difference between setting a price control

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[86] This has been particularly the case in the regulation of broadcasting: *R* v *Independent Television Commission, ex p TSW Broadcasting Ltd* [1996] EMLR 291 (HL); *R* v *Independent Television Commission, exp Virgin Television Ltd* [1996] EMLR 318.

[87] See Prosser, n 4 above, ch 1.

[88] See M. Loughlin, *Legality and Locality - The Role of Law in Central-Local Government Relations* (Oxford: Clarendon Press, 1996) ch 7.

[89] Teubner, n 76 above (1987) 10-19.

[90] Scott, n 22 above.

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for a particular enterprise and Teubner's example of a price freeze for a whole economy, where information and enforcement problems are indeed likely to make substantive legal prescription of only minimal effectiveness.

The second problem in applying the approach of reflexive law as the sole basis for our understanding of utilities regulation is that it leaves unanswered the problem underlying much of this paper; that of the substantive values which should underpin utility regulation. Of course, for reasons mentioned above, a reflexive law approach would reject the proposition that an economic approach to regulation has or should have priority in the political and legal sub-systems of regulation. But what would fill the void thus created? As Black has asked, '[i]s reflexive law simply a technique of intervention, a vessel into which any substantive purpose can be poured, or does it restrict not only the means by which substantive goals can be pursued, but those that can be pursued at all?'[91] It seems clear that a role for substantive values is envisaged in reflexive law; to quote Teubner,

> [t]he term 'proceduralization' of law is easily misunderstood from a technical-legal point of view. To interpret it as a recommendation to a 'post-interventionist' legislator to do without substantive legal norms and rely exclusively on procedural law instead would be to miss the point … substantive legal norms remain indispensable. It is only that the process of their production and justification has to give way to a 'socially adequate' proceduralization.[92]

Yet this continuing role for substantive values creates further problems similar to those identified in the discussion of stakeholder theory above; if we want to use participation of interests to determine the content of substantive standards, this requires a means of identifying which interests count, and how we are to balance them against each other. Such considerations have led to suggestions of the possibility of using reflexive law to assure constitutional rights; '[h]owever, whether we can simply download any political or constitutional theory or theory of rights we want is uncertain; moreover, the nonindividualistic basis of the theory of reflexive law means that insofar as they are focused on individual rights, current constitutional theories or aspects of them would have to be reformulated'.[93]

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[91] n 76 above 48-49.

[92] Teubner, n 76 above (1993) 66-67.

[93] Black, n 76 above, 50 (footnote omitted). Her discussion of this issue at 48-55 is a particularly illuminating one; cf C.B Grabner and G. Teubner, 'Art and Money: Constitutional Rights in the Private Sphere?' (1998) 18 OJLS 61.

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Conclusions: beyond proceduralism?

I have argued that both the legal model adopted for regulation of public utilities in the UK and the leading critical school of capture theory are inadequate for a proper understanding of regulation, and for prescription about how to improve regulation in practice. In both cases this is due to an unjustified privileging of the relations between regulator and enterprise as the subject of study whilst neglecting the pluralism actually characteristic of regulation. In terms of description and positive analysis of regulation, the regulatory space approach would appear to have much more to offer simply because it does not privilege any particular relationship in explaining or predicting how regulation will operate. However more is needed to provide analytical and evaluative purchase and normative principles as a basis for regulatory reform, as a guide for regulators and indeed for government in exercising its regulatory responsibilities. The answer might seem to be stakeholder theory, but this suffers from vagueness on the nature and weight of interests to be recognised as stakeholders. Proceduralism similarly would seem to have advantages in encouraging a more sensitive regulatory style but also leaves unanswered key questions of determining legitimate interests and their role in participation. Is there any way we can go beyond these theories to offer some solutions to these central question of regulation?

It has been suggested above that we abandon any pretence that a distinctive body of regulatory theory can be developed at this level; instead the better approach is simply to treat regulation as a sub-branch of government and so to return to political and constitutional theory. This will prove useful in two respects. The first is in setting the substantive principles which should underlie regulation; these may include those based on economic efficiency and those based on more distributive goals. The second is to identify the interests which should be taken into account in the procedural process and to give some criteria to be used in balancing them. Of course, both can be accomplished by examining the positive legal duties which apply to regulators, and the Review proposals may make this easier through tidying these up to some degree. Yet the statutes are not an exhaustive source of regulatory principle; if they were there would be no need for debate about how regulators should decide. In addition, the regulatory space should be seen as operating within a set of boundary constitutional principles. In other nations this would not be controversial; one has only to think of the importance of the US due process

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clause in shaping regulation there, or the development of the concept of public service in French constitutional and administrative law; other examples are familiar from the protection of public service broadcasting as a constitutional right in a number of jurisdictions.[94] In the UK, given the lack of a relevant set of determinate constitutional principles, a more speculative approach is necessary. One way of undertaking this would be an explicitly rights-based approach in which regulation is seen as operating in a framework of rights, including social and economic rights.[95] It is important to note that a rights based approach of this kind will not necessarily contradict the adoption of economic goals including market liberalisation. As Dworkin has argued, there may be a strong argument in many circumstances for markets as means of implementing rights on the ground that markets provide the best means of treating people as equals by ensuring that they take responsibility for the true costs of their actions; '[s]omeone who abstains from some act on the ground that it would cost his neighbour more than it would benefit him takes his neighbour's welfare into account on equal terms with his own; a duty to act in that way might be thought to rest on some egalitarian basis'.[96] Alter-natively the rights-based arguments may provide a justification for not implementing economic efficiency-based policies on the ground that we do not enter markets as equals and so such policies will defeat other values, such as ensuring access to essential social facilities on the part of the worst-off members of society.[97]

A more self-contained approach might be to take the participative or proceduralist emphasis as given, and to analyse the conditions which are implied for it to operate. This comes close to the approach taken in recent work by Jurgen Habermas.[98] To summarise the relevant aspects of some extremely rich (and dense) theorising, he accepts (for reasons of efficiency as well as of rights) that what is required is 'a "democratization" of the administration that, going beyond special obligations to provide information, would

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94 See R. Craufurd Smith, *Broadcasting Law and Fundamental Rights* (Oxford: Clarendon, 1997).

95 See notably A. Gewirth, *Reason and Morality* (Chicago: University of Chicago Press, 1978); *The Community of Rights* (Chicago: University of Chicago Press, 1996), and for applications see D. Beyleveld, 'The Concept of a Human Right and Incorporation of the European Convention of Human Rights' [1995] *Public Law* 577 and D. Beyleveld, and C. Villiers, 'A General Right to a Minimum Wage in English Law: An Argument from Generic Consistency' (1997) 17 *Legal Studies* 234.

96 R. Dworkin, *Law's Empire* (London: Fontana, 1986) 295 and see generally ch 8.

97 See eg A. Coote, *The Welfare of Citizens: Developing New Social Rights* (London: Institute of Public Policy Research, 1992).

98 Habermas, n 76 above. For an attempt to apply his earlier work in a related context see T. Prosser, 'Towards a Critical Public Law' (1982) 9 *Journal of Law and Society* 1.

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supplement parliamentary and judicial controls from within'.[99] This would appear to align him with proceduralism, but he also develops a scheme of rights which are required to institutionalise democratic processes of discourse. These include the traditional negative liberties, due process rights and rights of political participation but also social welfare rights which are necessary for any effective participation; '[b]asic rights to the provision of living conditions that are socially, technologically, and ecologically safeguarded, insofar as the current circumstances make this necessary if citizens are to have equal opportunities to utilize the civil rights …'.[100] This concept of rights as presupposed by participation can operate in two ways: on a micro-level as presupposed by democratic and participative procedures adopted by government and regulators, but more importantly on a macro-level of the rights presupposed by participation in the broader society in which regulation takes place. Such rights could include access to basic services such as those necessary for communication, access to a common culture through public service broadcasting and to basic means of subsistence in the form of energy and water. Moreover, a ranking of rights in this way might provide us with a means of ranking the interests of different stakeholders. Thus where rights are best met by market provision this might be where shareholder interests and those of consumers as market actors are all that need to be recognised; where social and economic rights come into play a broader conception of stakeholder would apply to include those who are disadvantaged in the market place but require access to public services and those who represent them. Less convincingly, it could be argued that the lack of representation of employees in the regulatory process is justified because an open labour market together with protection against such disadvantages as unfair dismissal are the means by which their rights and interests are protected, and so they need not be recognised as stakeholders in the regulatory context, though of course they may be in others. For example, it could be argued that protection is afforded against undue pressure for changes in the workforce and its conditions of employment through the Transfer of Undertakings Regulations.[101] However, if these protections are inadequate and if regulatory decisions create specific pressures on the workforce this may justify recognition of employees' interests in regulatory decisions.

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[99] n 76 above, 440.
[100] *ibid* 123.
[101] The Transfer of Undertakings (Protection of Employment) Regulations 1981, SI 1981 no 1794.

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A second approach which may simplify matters somewhat is to seek regulatory principle not only in political philosophy but as part of the international obligations to which government is party.[102] This is not entirely separate from the first approach but does give an opportunity to find relatively concrete norms as a basis for policy decisions. Thus it could be argued, for example, that the Council of Europe Social Charter could form the basis for developing social rights which could include the right to participate in essential services.[103] Much more important have been European Community obligations. In the utilities sector these have been concerned both with liberalisation and with protecting certain social rights within the process; this is well advanced in telecommunications but over the next few years is likely fundamentally to affect the energy sector also.[104] The role of European obligations is also becoming fundamental in the regulation of broadcasting and in particular of the new media.[105]

Two objections may be made to the approach suggested here. The first is a matter of principle; decisions of this kind are best left to elected governments on the basis of the argument from democracy mentioned early in this article and so are inappropriate for regulators. There is some force in this, but for a rather different reason from that of democratic legitimacy; as was argued earlier, governments are not necessarily more accountable than are regulators. However, governments are in a better position to take a view on the relevant matrix of rights and interests as a whole than is a regulator with specialist expertise in a particular sector. This argues for a form of policy guidance from government to regulators of the sort proposed in the Review, although this will not remove all regulatory discretion in particular instances. The second objection is a matter of practicality; it is difficult enough for regulators to be 'governments in miniature' without asking them to become philosophers writ large! The first response to this objection is, as suggested above, that the sort of rights I am proposing are not to be applied by regulators alone. In principle, it is possible to distinguish different levels of normative analysis

[102] See Beyleveld, n 95 above and Beyleveld and Villiers, n 95 above, for examples.

[103] N. Lewis and M. Seneviratne, 'A Social Charter for Britain' in Coote (ed), n 97 above. See also N. Prouvez, 'The European Social Charter: an Instrument for the Protection of Human Rights in the 21st Century?' (1994) 53 *The Review* (International Commission of Jurists) 30.

[104] For a summary see J. Pelkmans, 'Utilities Policy and the European Union' in Centre for the Study of Regulated Industries, *Regulatory Review 1997* (London: Centre for the Study of Regulated Industries, 1998) 111.

[105] S. Verhulst and D. Goldberg, 'The European Institutions', in Goldberg, Prosser and Verhulst, n 11 above.

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which could reflect a division of labour; Gewirth thus distinguishes, firstly, the constitutional and legislative level of enacting a constitution and laws which support the fulfillment of social and economic rights, and secondly, how they are best and most efficiently to be implemented.[106] In some cases this has been reflected in the actual distribution of responsibilities; for example, in the United States the important reforms of the Telecommunications Act 1996 relating to universal service set out six principles on which the regulatory authorities were to base their policies, whilst leaving details of implementation and the development of additional principles to the authorities themselves.[107] However, in the UK regulatory duties have been highly open-ended and this has made it inevitable that decisions have had to be taken on matters of principle by the regulators; the reforms proposed in the Review may go some way to improving this.

The second response to the objection based on impracticality is that there are signs that utility regulators are increasingly doing something similar in practice to what has been proposed here. The strongest example is that of universal service in telecommunications. This became a regulatory concern early on, but was then based very much on the application of solely economic principle; at the time of the 1986 price review the then Director General of Telecommunications accepted that some restraint on line rentals could be justified by the argument that the more customers who joined the telephone service the more valuable it would be for all customers but felt that it would not 'be proper for me to attempt to redistribute wealth by my policy on telephone pricing'.[108] During the mid-1990s, however, much more work was carried out by the regulator on universal service and this encompassed more clearly social concerns; the first consultative paper stated 'OFTEL has a responsibility to promote the interests of all consumers, including people with a disability or of pensionable age and a general duty to regulate in the public interest. A fair and equitable balance needs to be struck between the interests of different groups'.[109] The final consultative paper, whilst repeating the economic argument, stated:

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[106] Gewirth, n 95 above (1996), 327.

[107] Telecommunications Act 1996, 47 USC §§ 151 *et seq*, s 254(b); for the outcome of the regulatory process see Federal Communications Commission, *Report and Order in the Matter of Federal-State Joint Board on Universal Service* (Washington: FCC 97-157, 1997).

[108] OFTEL, *Review of British Telecom's Tariff Charges* (London: OFTEL, I986).

[109] OFTEL, *A Framework for Effective Competition* (London: OFTEL, 1994) para 12.1; for a more detailed account of the consultation process see Prosser, n 4 above, 78-83.

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> [t]he concept of universal service is based on the premise that telecommunications services now play such a fundamental role in our society that all people, whoever or wherever they are, must have access to a certain basic level of telecommunications facilities and services if they are to participate fully in modern society. The concept of universal service is well established in the UK, having been a feature of telecommunications service since long before BT was privatised. It provides a safety net - ensuring that people who may otherwise miss out get access to a basic level of service. It is also a dynamic concept and one which will evolve over time.[110]

This philosophy has also been strongly influenced by European Community developments which have themselves developed a sophisticated concept of universal service.[111] Thus we see a progression from an argument based on economic efficiency to one based on a right to participate and a right to a basic service.

In conclusion, my argument has been that study of utility regulation suggests that such regulation is an essentially open process and cannot, and indeed should not, be reduced to any particular logic, economic or otherwise. The bilateral approach and capture theory deny this complexity and so remove the richness from regulatory activity; because of this they are of limited utility either in predicting regulatory behaviour or in providing normative principles of how regulators should act. Public choice and stakeholder theories suffer from similar problems. The simple answer might be to abandon any search for regulatory theory and say that regulation is merely a part of politics and treat it as such. This does not however mean that it is arbitrary or simply a matter of contingent compromises between interests, for some ways do exist for developing more sophisticated regulatory principles without artificially pushing the regulatory process into simplistic theoretical straight jackets.

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[110] OFTEL, *Universal Telecommunications Services: Proposed Arrangements for Universal Service in the UK from 1997* (London: OFTEL, 1997).

[111] See eg Commission of the European Communities, *Developing Universal Service for Telecommunications in a Competitive Environment*, COM(93)159 (final); European Parliament and Council Directive 98/10/EC on the application of open network provision to voice telephony and on universal service for telecommunications in a competitive environment, OJ L 101, 1.4.1998.

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