



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

14 February 2019

Sir John Armitt
Chair
National Infrastructure Commission
4th Floor, Finlaison House
15-17 Furnival Street
London
EC4A 1AB

Dear John,

NATIONAL INFRASTRUCTURE COMMISSION STUDY ON REGULATION

I am writing today to set out the Terms of Reference for the National Infrastructure Commission study on economic regulation, which was announced last autumn.

The National Infrastructure Assessment (NIA) highlighted the UK's future investment needs to 2050, and the challenges of population growth, climate change, and technological change. It is therefore important the regulation study considers how to refresh our regulatory system to drive further positive outcomes in the utilities sectors in light of these challenges. As an independent and expert body, the Commission are well placed to consider these issues and I look forward to the publication of the final report in the Autumn.

I attach the Terms of Reference to the study, which reflect feedback from the Commission on the proposal. The study should build on work that my cabinet colleagues are doing in this area, and I would encourage you and your commissioners to engage directly with them through the course of the study.

At Budget the government published a full response to the Commission's Oxford-Cambridge Arc report, and provided an interim response to the NIA, setting out the first steps towards meeting the priorities laid out by the Commission. This included setting out further details of the new National Roads Fund, further support to deploying full fibre broadband in rural locations and extending the Transforming Cities Fund. The government will respond in full to the recommendations set out in the NIA with a comprehensive National Infrastructure Strategy this year. I also welcomed your interim report on the future of freight, ahead of the final report this Spring.

A handwritten signature in black ink, appearing to read 'Philip Hammond'.

PHILIP HAMMOND

Regulation Study Terms of Reference

The aim of this study is to assess what changes might be necessary to the existing regulatory framework to facilitate future investment needs, promote greater competition and increase innovation, and meet the needs of both current and future consumers. The scope of the study is the key regulated infrastructure sectors: telecoms, energy, water.

The economic regulatory framework is central to the provision of infrastructure, with Ofcom, Ofgem, Ofwat monitoring and refereeing how infrastructure is funded, delivered and operated within their respective sectors.

This study will consider how the regulatory system can adapt to meet future challenges. The key issues it should address are:

1. **What the future changes are that will affect the regulated sectors** – The National Infrastructure Assessment identified the UK’s infrastructure needs to 2050. The study should set out the key drivers of change in the coming decades, and consider:
 - a. The relative impact and importance of these changes, and the impact on investment needs
 - b. How these changes are likely to affect the functions and scope of regulators
 - c. The ways in which regulation might need to adapt over the coming years in light of these challenges
2. **Competition and innovation** – Has the regulatory model facilitated enough competition and innovation to support investment, efficient delivery of infrastructure and the interests of consumers? How can regulators be more “adaptive” to respond to and encourage innovation? The study should consider:
 - a. Evidence on the ability of regulators to promote high performance from utility companies and discourage underperformance
 - b. Evidence on levels of competition and new entrants in different sectors
 - c. Evidence on the role of competition and innovation in driving positive outcomes for consumers
 - d. Current barriers to regulatory adaptability; how to improve the speed at which regulation responds to change, and the role of data in supporting this
 - e. Mechanisms for encouraging innovation and competition within regulators and industry, and those that allow regulation to be more adaptive to deal with new technologies
3. **Regulatory consistency** – Drawing upon international examples and best practice where relevant, the study should consider how the regulatory framework can facilitate collaboration on cross-cutting projects and challenges and protect the interests of consumers, including:
 - a. Whether existing regulatory, legislation, licencing and governance structures effectively promote collaboration, efficiency, regulatory consistency and scrutiny



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- b. Whether consistency has an impact on the delivery of significant infrastructure projects which involve multiple utility sectors
 - c. Whether regulators have worked together adequately on cross-cutting issues, and how this can be improved
 - d. The similarities and differences in the legislation underpinning the regulators, how this affects their approach, and how this might evolve after EU exit
- 4. How government and regulators work together** – How Government is able to effectively deliver its priorities for the regulated sectors, whilst continuing to safeguard regulatory independence. The study should consider:
- a. What the relationship is between Government setting policy and strategic direction and regulators' approach to their sectors
 - b. How this might be improved, to better deliver Government objectives, and support collaboration, whilst safeguarding the regulatory independence which is key to the model and essential for investors

In taking forward this work the Commission should work with HMT, BEIS, DEFRA, DCMS and other relevant government departments, the economic regulators and the UKRN, industry bodies and stakeholders, academics and institutions, and consumer groups. These departments will lead HMG's engagement with the Commission in areas which concern regulators or bodies for which they are responsible.

The Commission should also have specific regard for outcomes for consumers when conducting its review and as part of this should take account of distributional issues, consumer disengagement and the scale and quality of consumer protections across the regulated sectors.

The Commission should ensure that its recommendations do not directly undermine the UK's regulatory institutions or their existing work programmes, nor negatively affect how the government currently works with stakeholders across regulated industries.

Recommendations should be consistent with the government's fiscal and economic remits, take into account the fiscal and consumer bill impacts in the National Infrastructure Assessment, and not have significant impact on the public balance sheet. Recommendations should also consider the full range of implications for regulated sectors, including the need to ensure bills are affordable and vulnerable consumers are protected.

Any recommendations impacting individual regulators, or their specific sectors, issued by the Commission are to be considered and Government's collective response to be proposed by the Secretary of State of those regulators' sponsoring departments.

The Commission should report on the regulation study in Autumn 2019.