

# Customer engagement

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Customer engagement has spread remarkably throughout the regulation of the United Kingdom's gas, electricity and water networks. Yet only a dozen years ago only two people in the country were exploring that concept as we know it today. One was Harry Bush, inventing the concept (as constructive engagement) in airport regulation at the Civil Aviation Authority (CAA). The other was myself, talking to everyone who knew about it outside the country, mainly in North America but also in Argentina.

The UK concept is novel. It adapts North American negotiated settlements to include a significant role for the regulator in determining some, but not all of the parameters of the price control. It is proving attractive in yet other countries too. I talked about the approach in Australia and New Zealand this summer and in Ontario (Canada) just last week, and all have expressed great interest in this approach.

Why did the idea catch on so fast? Partly because the concept seems to have been attractive to companies, customers and regulators; they often said it was 'the obvious next step in regulation'. And partly, because over time an increasing number of examples of it working were fed into local discussions, so that it became a practical option, not a theoretical possibility.

The idea that the role of the regulator might be to facilitate the market process rather than to take all the decisions now, seems to me, indeed, an obvious as well as an attractive one. But if it was such an obvious and attractive next step, why did we not see and adopt it earlier? In the 1980s Michael Beesley and I spent many hours – years – discussing privatisation and regulation, but this idea never occurred to us. In the 1990s I must have been involved in about 50 electricity sector price controls, and again the idea never occurred to me. Why not?

One reason is that the North American experience of negotiated settlements that so attracted me when I discovered it in the 2000s was still in its infancy in the 1980s and 1990s. It was not reported in the textbooks or in journal articles, apart from the honourable exception of the less known PhD thesis of Paul Joskow (1972) PhD thesis.

A second reason is that we didn't yet realise we had a problem to which the answer was customer engagement. In the 1980s and 1990s it seemed natural and effective for regulators to set price controls after hearing the views of companies and customers. Typically, the process took only a year or so and yielded significant price reductions and quality improvements. It was not until the 2000s that the full awfulness of the price control review process began to be apparent. By that I mean the disadvantages

noted by Ofgem in its RIIO review<sup>1</sup>, including the time taken – by then more like three or more years to set a five-year control – and the cost and complexity involved, the lack of incentive for good business plans, and the focus of companies on the regulator rather than the customer.

Perhaps a third reason was that the focus in the early years was on increased efficiency, which did not need much customer input. Over time the emphasis changed to discovering and meeting customer preferences, which did need more customer input and left the regulators more exposed.

What of the future? Harry Bush and John Earwaker (2015) have produced a tremendous evaluation of the experience of the four regulators CAA, Ofgem, Ofwat and WICS. Their recommendations for an improved process next time seem to me very well grounded. They identify three broad approaches: (a) for a somewhat more conservative approach to customer engagement; (b) for something along present lines; and (c) for something more adventurous. I confess that my preference would be for an option (d) – giving companies and customer groups maximum scope to negotiate agreements. But bearing in mind though not constrained within guidelines laid down by the regulator. As I have set out elsewhere, I should like to envisage the possibility of competition between company and customer groups in setting price controls (Littlechild 2014: 152–61).

Let me instead focus on two issues that are noted but not explored in detail in the above report. The first is the suggestion that certain issues – notably cost of capital and future cost efficiencies – should be left to the regulator because it has a comparative advantage there. This is because it has economies of scale as it would be more costly for a dozen separate customer groups to carry out the necessary research – and it has legitimacy as a body appointed by customers to represent customers.

But CC Water in the water sector also has economies of scale and also has legitimacy. So why should priority be given to one or the other statutory bodies? My tentative inclination would be to encourage a customer body to undertake such research and provide advice, with the role of the regulator focusing on resolving disputes in the event of failure to agree.

The second issue is that regulators might not always be enthusiastic about customer engagement. Some commissioners might ask whether they should delegate their powers and responsibilities to an ad hoc customer group. Surely, they would say, it is our job to interpret the needs of customers and to determine trade-offs such as between quality and price. This view from commissioners might manifest itself at the beginning, middle or end of the price control review process, perhaps unpredictably.

This is an understandable view, but if the role of customer engagement is to be developed, as I believe it should be, then commissioners need to be informed and

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<sup>1</sup> RIIO stands for Revenue = Incentives + Innovation + Outputs.

assured that their role is to facilitate customer engagement rather than to pre-empt it by taking all decisions. The Alberta Utilities Board Act 1995 has an important provision, specifying that ‘the Board must recognise or establish rules, practices and procedures that facilitate negotiated settlement’. We might consider adapting this to the GB context, for example by requiring that ‘the regulator must recognise or establish practices and procedures that facilitate customer engagement, and more generally agreement between licensees, users, customers and customer representatives’.

I am tempted to go further, to suggest that regulators should not be allowed to impose regulations unless they have previously sought to encourage negotiated settlements to similar effect, but perhaps that is for a later time. For the moment, the main thrust of policy ought to be to require all regulators to facilitate customer engagement. That is progress enough for the moment.

### *References*

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