

Consumers on tap?

Eva Heims and **Martin Lodge** consider the remarkable rise of consumer engagement processes in utility regulation in the UK

Putting the consumer at the heart of regulation has become one of the central themes in contemporary UK utility regulation. In particular, the water sector has witnessed considerable attention, with Scotland and England having experimented with rather different mechanisms. So where does the idea for consumer engagement come from? Does consumer engagement challenge or complement the synoptic controls of technocratic (RIP-X) price-setting regulatory agencies that were supposed to be at the heart of UK utility regulation? And what can we learn from the Scottish and English experiences?

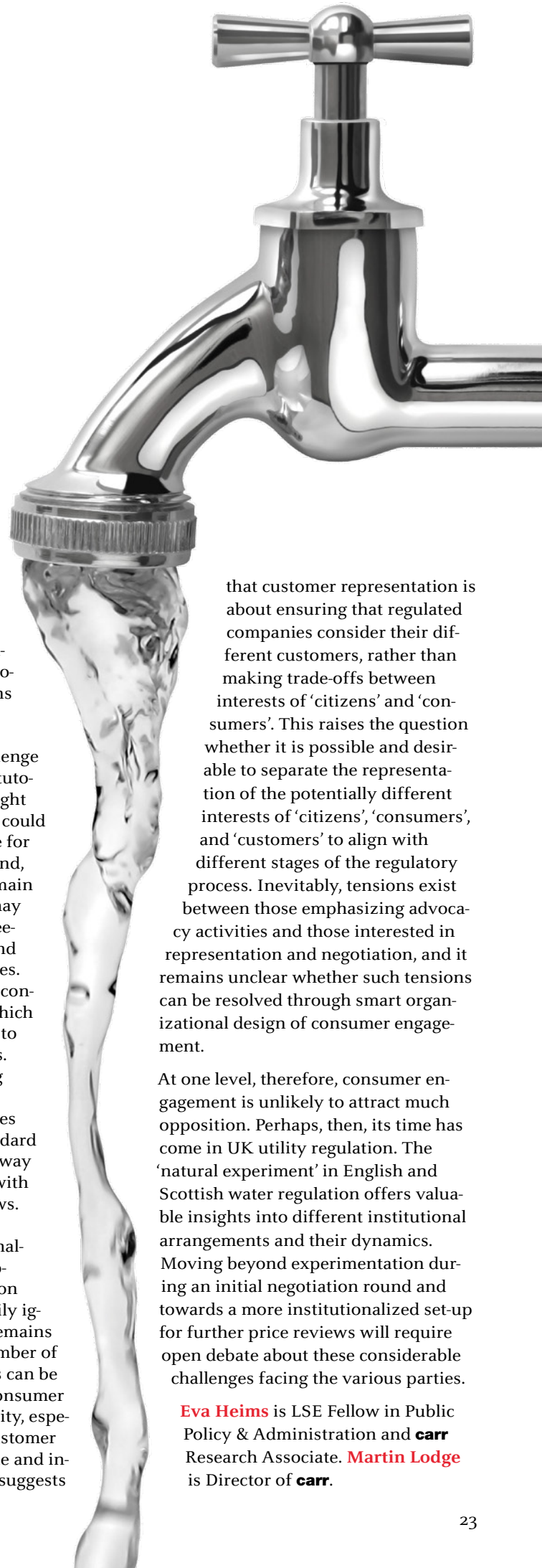
Ideas of consumer engagement and negotiated settlements in regulation are far from novel. These ideas offer considerable variations in terms of who is involved and what is being negotiated. Alternative forms of rule making, relying on direct negotiations between regulators and select parties, have been a long-standing feature in planning and environmental regulation. Indeed, the US Negotiated Rulemaking Act of 1990 created its own brief cottage industry of academic reflections, most of them with somewhat mixed results. In the area of North American utilities regulation, negotiated settlements have featured among some state regulators, and it is this experience that has received considerable attention, in the UK context, by Stephen Littlechild. Littlechild established the intellectual blueprint for the UK's utility reforms in the 1980s and 1990s, and he has been at the centre of prompting the use of innovative consumer engagement processes in UK utility regulation.

The idea of consumer representation in UK utility regulation is, of course, not particularly new either. The 'old' age of publicly owned utilities was characterised by a range of consumer representative bodies. While some managed to survive into the age of privatisation, the key emphasis has been on relying on regulatory bodies themselves to play a consumer representation function since the 2000s. Since the late noughties, the emphasis has turned to focusing on consumer representation being moved towards direct interaction with the regulated firm. The water sector across the UK has been prominent in this regard.

What explains this shift towards consumer engagement in utility regulation, especially at a time when wider consumer representation issues in UK regulation are arguably witnessing pushback in respect of organisations and finances? One of the main triggers for the growing attraction of consumer engagement strategies is the exhaustion of existing regulatory instruments. Increasingly, questions have been asked as to whether price reviews offer a valuable regulatory strategy as industries have adapted to regulatory requirements, regulators have become overwhelmed by methodological demands, regulatory relationships have hardened, and the value of benchmarking information has become exhausted. Introducing novel ways of challenging companies to stretch themselves further when devising their business plans is said to encourage different, less institutionalized discovery processes that might provide new insights. Being able

to legitimize decisions by relying on 'consumer engagement' might also reduce the vulnerability of regulators and regulated industries to political and public pressure.

The UK water sector has witnessed an emphasis on consumer engagement since the late 2000s – with Scotland and England offering interesting differences in their approach. The Scottish experience – involving the publicly owned Scottish Water – was characterised by a substantial delegation of authority to the 'Customer Forum' under a tripartite agreement between the regulator (WICS), the consumer representative body (Consumer Focus) and the regulated company (Scottish Water). During the process, the Customer Forum and Scottish Water effectively negotiated an agreement on the company's business plan, and the regulator largely accepted this agreement. In England, 'customer challenge groups' were established at the level of each private regulated company, with an additional consumer representative panel engaging with the water regulator, Ofwat. The English regulator was less willing to delegate decision making to the various customer groups. In the end, Ofwat made only very timid use of the possibility to 'fast-track' the price review for companies that presented business plans based on extensive customer engagement. It is difficult to assess the outcome of these different approaches. However, participants of the Scottish experiences regard their agreement as a general success in terms of substance and process. It is suggested that England could potentially learn



from this 'best practice'. Others point to key differences, most of all regarding ownership structures.

Whatever the merits of these different approaches, before extending the scope for negotiated settlements more generally, a number of questions need to be confronted:

One question is about the institutional status of consumer engagement. As noted, the English version placed consumer engagement at the level of the regulated firm in contrast to Scotland's tripartite agreement. The latter potentially offers greater commitment on behalf of all interested parties in supporting the process and eventual agreement, but may be seen as uncomfortable for those interested in consumer advocacy rather than negotiation. It also requires institutional resource commitments across all parties that may not always be available, as occurred in the case of the now disbanded Consumer Focus in Scotland.

For regulated firms, there are concerns about biases in decision making (short-term over long-term horizons, domestic over business consumers), which will always be present in negotiated settlements. Decision making led by detached econocratic regulators has often been seen as a solution to these problems in the past. There are also differences as to whether private institutional investors welcome negotiations with customer representatives, or whether they prefer the comfort of dealing with technocrats in regulatory offices. In addition, firms require safety nets as agreements work themselves out in

practice. Such mechanisms may require careful specification, might call for independent monitoring and automated review provisions to avoid gridlock.

For regulators, the challenge is one of delegating statutory functions. Cynics might suggest that delegation could be a convenient avenue for blame-shifting. In the end, however, regulators remain still in charge as they may or may not 'accept' agreements between firms and customer representatives. Yet, differences remain concerning the extent to which regulators are 'minded' to accept such agreements. Furthermore, providing bespoke intelligence to customer representatives requires change in standard operating procedures away from those associated with 'traditional' price reviews.

Finally, there are also challenges for customer representation. The question of legitimacy is not easily ignored as it inevitably remains questionable how a number of high profile individuals can be said to represent 'the consumer interest' in all its diversity, especially in areas where customer preferences are unstable and information sparse. This suggests

that customer representation is about ensuring that regulated companies consider their different customers, rather than making trade-offs between interests of 'citizens' and 'consumers'. This raises the question whether it is possible and desirable to separate the representation of the potentially different interests of 'citizens', 'consumers', and 'customers' to align with different stages of the regulatory process. Inevitably, tensions exist between those emphasizing advocacy activities and those interested in representation and negotiation, and it remains unclear whether such tensions can be resolved through smart organizational design of consumer engagement.

At one level, therefore, consumer engagement is unlikely to attract much opposition. Perhaps, then, its time has come in UK utility regulation. The 'natural experiment' in English and Scottish water regulation offers valuable insights into different institutional arrangements and their dynamics. Moving beyond experimentation during an initial negotiation round and towards a more institutionalized set-up for further price reviews will require open debate about these considerable challenges facing the various parties.

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