

## Closing time? Regulatory agencies and consumer engagement in economic regulation

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Regulatory agencies were the future once (cf. Majone 1997). Gone are the days when regulatory agencies appeared to be the universal remedy for all policy problems in economic and other fields of regulation, especially of the ‘badly structured’ kind (Vibert 2015). Regulatory agencies were promoted as universal remedy for problems of political interference in regulated industries, of ensuring expertise judgement in regulatory affairs, or of reducing the ability of industries to capture the political agenda. Similarly, gone are the days where ‘modern’ regulatory methodologies, such as the price-capping RPI-X formula in the regulation of utilities, were regarded as promising a low cost incentive scheme to encourage efficient industries.

The loss of faith in the ‘agency remedy’ can be traced to three central criticisms. Firstly, concerns about ‘independence’ have focused on the appropriate relationship between agencies and politicians, as well as between regulators and the regulated industry. There have always been concerns about unelected ‘big beasts’ in regulatory offices or, in contrast, about timid decision making in light of private investor pressure. Further debates have focused on the ways in which ‘technocratic’ decision making has been standing in the way of politicians’ grand designs. Others have pointed an accusing finger at the ways in which politics has sought to entrench its views, whether directly through appointment or procedural guidelines, or indirectly through wider political ‘mood-setting’. Equally, long-standing concerns about regulatory ‘capture’ continue to form part of the debate about the fallibility of regulators (cf. Peltzman 1989; Carpenter and Moss 2014).

Secondly, concern has also been raised about the role of the consumer. As noted by Vibert (2015), competition has not brought about the kind of markets where consumers appear to make ‘efficient’ choices; this has encouraged some regulators to become increasingly prescriptive in the ways in which companies are supposed to package their products and/or ensure that potential customers make informed choices. This concern stands alongside a more long-established concern about the role of consumer representation in regulatory industries.

Thirdly, there has been increasing disillusionment with the established tools of economic regulation, most of all the once widely celebrated RPI-X mechanism. This mechanism was supposed to avoid the problems of US-type rate-of-return

regulation (Averch Johnson effect). But it is widely accused of having become a cumbersome process that encourages second guessing and gaming among regulators and regulated industries alike without any evident superior outcomes, while putting considerable strain on the relationship between regulator and regulatees.

As regulatory agencies have increasingly become part of the problem rather than the solution, the theme of ‘consumer engagement’ has been put forward. In contrast to the previous era where there was broad agreement on the contours of agency ‘independence’ and the application of price-capping methodologies, there is little agreement as to what consumer engagement might actually imply. For some, consumer engagement offers the promise of negotiated settlements. For others, it is mostly a way of encouraging regulated industries to become more responsive to their customers’ interests. Consumer engagement is advocated by those interested in deliberative and participatory process and by those interested in reducing the role of regulatory agencies and the bureaucracy surrounding price reviews and other key regulatory decision making processes.

Besides some instances of negotiated settlements in North America (Doucet and Littlechild 2009; Littlechild 2008, 2009), the call for customer engagement has been particularly prominent in the case of the UK. Different economic regulators have experimented with processual innovations to encourage direct engagement between regulated industries on the one hand, and customers and other affected parties on the other. One sector where this call for more consumer engagement has been particularly prominent is water. The contrasting examples of Scotland, and England and Wales, offer critical insights.

In both cases, consumer engagement was to take a prominent role in recent price review processes that were completed in 2014. Industry structures did vary – Scotland’s water sector is organised through a publicly-owned provider with (some) retail competition, whereas England and Wales have private and ‘public interest’ companies organised in regional monopolies. In Scotland, consumer engagement reflected a tripartite agreement between company, regulator, and consumer organisation that was to engage directly with the company, whereas the English and Welsh experience involved consumer negotiations organised at the company level. Whereas the Scottish regulator signalled its principle willingness to accept a negotiated agreement that the customer body and the company could agree to, the scope for agreement in the case of England and Wales was smaller. In the English and Welsh experience, customer challenge groups included other regulators, whereas in the Scottish case, the environmental and drinking-water quality regulators were consulted, but not involved in the customer body as such. In Scotland, the regulator (WICS, Water Industry Commission for Scotland) provided the consumer group (the ‘Customer Forum’) with background information to

inform negotiations (see ‘WICS Notes’, e.g. WICS 2012), whereas Ofwat decided to play a more detached role to encourage a decentralised ‘discovery process’, given also the highly diverse nature of different water companies under its jurisdiction.

In the end, WICS did accept the agreement between customer representatives and company, while Ofwat mostly revised the various customer agreements, usually leading to ‘tougher’ settlements on companies. Whereas participants in the Scottish process, with the exception of consumer organisations, praised their experience (Customer Forum 2015), enthusiasm for consumer engagement in the other parts of Britain was dampened by the experience of the intervention by Ofwat after companies had extensively engaged with their customer challenge groups (cf. CC Water 2015). Although many water companies and challenge groups in the English and Welsh context found this engagement process beneficial and rewarding in their direct interactions with each other, their perception of its overall value was significantly hampered by the seeming lack of respect for these processes on the part of the regulator.

What do these contrasting experiences tell us about the future of regulatory agencies?

It offers one insight into the changing role of the consumer in regulatory processes. Whereas most recent attention has been placed on behavioural impact-influenced interventions to supposedly enhance the quality of consumer choice, the process of customer engagement moves consumer representation away from existing consumer protection bodies or from regulatory agencies themselves to the level of the firm. At first sight, this seems to usher in a new era of regulation, putting the relationship between firms and consumers at its heart, at the expense of the previously prominent role of regulatory agencies. However, at second sight, agencies have not lost their central role despite the increased prominence of consumer engagement. The experience in the Scottish water domain suggests that the efficient secret of the process was the fancy footwork performed backstage by WICS. This could have been by providing information to the customer representatives or by shepherding the various parties along during the process – while needing to persuade its own members that this process did not represent an abdication of regulatory competencies. In other words, regulatory agencies remain central in this process rather than being sidelined by emerging alternative decision making arenas.

However, it might still be argued that customer engagement leads to different kinds of outcomes. This argument has certainly been made in the case of Scotland where the eventual settlement was seen to have been tougher on Scottish Water than WICS had envisaged at the outset of the process. There is also the possibility that

the company will strive more seriously to meet the regulatory demands of the last price review because of its ownership of these demands, having itself negotiated them with the customer body. The Scottish process also established a different kind of customer research in an area where customer preferences are rarely ever fully formed. Again, however, it might be questioned whether the same can be said about the English and Welsh experiences.

Finally, as Vibert (2015) suggests, regulatory agencies were once seen as a persuasive institutional arrangement to address ‘badly structured’ problems. Mick Moran (2003) similarly noted that the era of the regulatory state gained attraction exactly because of its promise to establish synoptic and consistent control that would move beyond the informalities of the earlier era of regulation via ‘club government’. A move towards consumer representation and negotiated settlements might be seen as a different answer to the challenge of the ‘badly structured’. Instead of a reliance on disciplined econocrats doing methodologically ever more complex calculations to remove arbitrary political decisions, customer engagement processes offer the possibility of locally adaptive discovery processes. Rather than operating as judge-type econocrats, the role of regulators might appear to have become increasingly one concerned with boundary spanning, namely, the bringing together and sustaining of consultative processes. Boundary spanning offers a different answer to the problem of the ‘badly structured’ by promoting the possibility of higher degrees of intelligence in decision making through decentralised information processing. Unfortunately, it is unlikely that boundary spanning will turn the ‘badly structured’ into the ‘well structured’ when it comes to entrenched conflicts that generate identifiable winners and losers. In addition, customer representation will always face its own problems of legitimacy. Negotiated settlements require the involved consumer body to directly represent ‘what customers want’ in the negotiation process. Other arrangements – such as the English and Welsh experience – require consumer groups to assess the responsiveness to consumers and the overall quality of consumer research used by regulated companies. As is the case with the tension between independence and accountability where regulators are concerned, the inherent tension between ‘real influence’ of customer bodies and their representativeness is here to stay.

Furthermore, it is unlikely that the traditional core attractions of the ‘agency model’, namely to instil the ‘logic of discipline’ into regulatory decision making will fade away (cf. Roberts 2010). International investors will continue to be more interested in ‘consistency’ rather than responsiveness to decentralised negotiations. In other words, mobile international finance is unlikely to be enamoured of increased customer engagement if this leads to less predictable regulatory decisions. Similarly, customer representation will always face the problem of organising sufficient expertise and representative legitimacy. Regulatory agencies are arguably well placed to respond to these two challenges by promising

‘consistency’ and expertise – and they are also well placed to argue their case. In other words, even if regulatory agencies may have lost the glamour of hyper-modernity, they most certainly are not ready to be consigned to the dustbin of history.

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