

Consumer Involvement in Regulatory Decision-Making

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Outline

- Three preliminary remarks.
- The different forms of consumer involvement in regulatory decision-making observed around the world.
- The potential benefits and possible limitations of the different approaches.
- The potential applicability of the different forms of consumer involvement in other contexts.

Three preliminary remarks

‘We the people (consumers)’

- General agreement that having ‘the people’ involved in regulation is a good thing.
- But where are they in this process?
- How are their views most effectively represented/heard?
- Are there any areas where we may not want consumers’ views fed into process?
- What is the interaction with the political process?

Three preliminary remarks

The importance of context.

- Akin to democracy – many types of citizen participation can be observed in different democracies.
 - Difficult to generalise about which is more or less effective without having regard to wider institutional framework.
 - Does compulsory voting in Australia mean citizens views are better represented than in other democracies?
- The suitability of specific consumer involvement mechanisms depends on wider regulatory arrangements.
 - E.g.: Consumer challenge panels can work in a context where regulatory process rewards active participation (i.e.: fast-tracking; financial incentives etc).

Three preliminary remarks

Which ‘consumers’ are we talking about?

“But do customers think the investment is worth paying for? Would they prefer more or less investment, or different kinds of investment? Would they make the same decisions themselves? Ultimately, they are not able to do so. Customers are effectively deprived of choice, and regulators decide on the basis of limited information.”

Stephen Littlechild: ‘Some Alternative Approaches to Utility Regulation’ *Economic Affairs* (2008)

Three preliminary remarks

Which ‘consumers’ are we talking about?

“Behavioural economics emphasises that consumers have a limited capacity to assess the goods and services offered to them...”

....Retail consumers of energy in GB have been free to choose between a range of gas and electricity suppliers for over a decade. However, consumer engagement is still low.

.... A key insight is not only do behavioural biases exist that may limit consumer engagement, but they might be widespread and predictable too.

...A key ‘bias’ is limited capacity, ie: finite time and ability to process information”

Ofgem, March 2011

“These proposals – based on Ofgem’s Retail Market Review (RMR) – will put an end to consumers being bamboozled by complex tariffs and deliver choice that consumers easily understand.”

Ofgem, November 2012.

**Degree of
consumer
involvement**



Consult/Respond: Regulator determinative in all cases, some scope for consumer input

Consumer panels/advisory committees:
Regulator determinative in all cases, but views of consumer representatives can feed into decisions.

Constructive engagement: Regulator determinative, but companies encouraged to consult with consumers, and to reach agreement on specific issues.

Negotiated agreements/settlements:
Companies and consumers negotiate directly and try to reach agreement without the regulator playing a major role. Regulator only becomes determinative in the event that agreement cannot be reached between the parties (or an agreed settlement is inconsistent with its legal obligations).

Consult and respond

- Consumers are given an opportunity to respond to consultations on major regulatory decisions, but the regulator takes the final decision.
 - Adopted by many regulators around the world.
 - Can take different forms: public hearings/ workshops; respond to Draft Decisions; private meetings with representative bodies.
 - Multiple opportunities to respond to Issues Paper, Draft Decision etc.
 - Consumer representative bodies may ‘represent’ consumers by making submissions through these processes.

Consult and respond

Potential benefits:

- Generally, wide discretion given to consumers as to how to interact/respond.
 - No restriction on submission of expert reports/ opinions, or the length or type of response.
- Relatively inexpensive.
 - However, consumers bear costs.
- Open to everyone to respond
 - Avoids any potential misalignment between consumers and consumer representatives.

Consult and respond

Possible Limitations:

- Given technical nature of the issues, in practice only large and well resourced consumers can participate.
 - Difficult for households/residential consumers to actively participate.
 - May be represented by large intermediate users, but depends on the issue (i.e.: extent of pass-through of costs).
- What happens to the responses?
 - How does regulator take account of responses? How are different views balanced?
 - Can lead to disengagement.
- Increasingly seen as a necessary, but insufficient, form of consumer involvement.
 - Supplemented with other forms of consumer involvement.

Consumer panels

- Representatives of consumer interests are invited to participate in specialist consumer panels or advisory committees to provide the ‘consumer view’ in some aspects of regulatory decision-making.
- Final decisions still, however, typically rest with the regulator.
- Considerable diversity in design, funding and status of consumer panels across industries/jurisdictions.
 - Some observations from the ACCC’s *Better Regulation of Infrastructure Project*

Consumer panels

- No uniform size: from 10 to the 100+
- Composition varies: wide cross section to represent all demographics, to those with more industry specific knowledge.
- Differences in the extent to which other parts of government can participate.
- Scope of powers/responsibilities differ – some charged with specific advice on price controls, others more general ‘sounding out’.

Consumer panels

Potential benefits:

- Can address the ‘representation gap’ associated with standard consult and respond mechanism.
 - The voice of the small consumer/household.
- Ensures that regulator hears the ‘consumer view’ on all relevant issues.
 - In addition, can allow for diversity of views to be represented.
- Can build expertise over time and engage on technical issues.

Consumer panels

Possible limitations:

- May not be as ‘representative’ as hoped
 - *“Middle class professional early retiree looking to make a public service contribution”* Franceys and Gerlach (2011).
 - Over time, long-standing members may become less representative of the ‘consumer view’.
- How are the panels’ views taken into account by the regulator?
 - Customer advisory committees in water industry:
 - *“...members expressed disappointment that their responses appeared to be of very limited value. By their own perception, their role did not appear as effective as they might have envisaged at the time of their individual appointments or that might be presumed by observers”.* Franceys and Gerlach (2011).
 - Contrast with Byatt (2013).

Consumer panels

Which issues are championed?

- Differences between proxy advocates (Offices of Consumer Advocates) vs. grass-roots advocates.
- Proxy advocates may focus on immediate issues which they believe all consumers have in common (such as reductions in rates).

“[C]onsumers do not benefit uniformly, however, from institutionalized representation...all else equal, consumer advocates, on average, thus leave residential consumers worse off but industrial consumers better off”. Holburn and Spiller (2002)

“Consumer organizations rarely put efficient pricing high on their list of proposed remedies, evidently partly for fear that the result will be higher prices for scarce services” Kahn (2002).

Constructive engagement

- Regulated companies are required to consult with consumers about their activities, and, in particular, their submissions in relation to price controls (such as aspects of their business plans).
- The regulator, however, remains the determinative body.
 - In practice, regulator may take account of the fact that agreement has been reached.
 - Difference with negotiated settlements may, in some cases, be one of degree, rather than kind.

Constructive engagement

- Origins in UK airports sector.
 - Regulator structured discussions between regulated firms and users (consumers) and identified types of issues and topics to be addressed.
 - Issues addressed: volume and capacity requirements; nature and level of service outputs; potential opex efficiencies; future capex levels; service quality issues to which incentives could be attached etc.
 - Outcome of process was advice to regulator, which was not binding.

Constructive engagement

- ‘Enhanced engagement’ in the British energy sector.
 - Places burden on company to consult with their users on key issues relating to business plans and ‘primary outputs’.
 - Financial incentives, and ‘fast-tracking’ if it can be demonstrated that consumer views taken into account.
 - Types of issues addressed: safety, reliability, environment, consumer satisfaction.
- ‘Consumer challenge panel’.
 - ‘Critical friend’ to Ofgem. Six members.
 - Meets with companies to discuss business plans, and with price review team.

Constructive engagement

- Water industry in England and Wales from 2014
 - Each company must undertake ‘local engagement’ regarding business plan.
 - Includes quantitative evidence.
 - Thames Water has established a 2,000+ customer panel.
 - Each company responsible for establishing a consumer challenge panel.
 - Charged with ensuring that the package is acceptable to consumers.
 - Sector-wide customer advisory panel to influence Ofwat’s thinking.

Constructive engagement

Potential benefits

- Encourages regulated companies to ‘build relationships’ with consumers.
- Can make consumers better informed about activities of firm, drivers of price changes, and constraints on decision-making.
- Allows consumers and firms to focus on the issues that they think are important.
- In energy, has had real effects in decision-making on some important issues.

Constructive engagement

Possible limitations

- Requires the process to be structured and managed: sequencing, disclosure of information etc.
 - Can be burdensome, and raise costs for all parties.
- Early concern in airports about information asymmetry between parties, and absence of dispute resolution process.
- Some teething problems in energy as well, but improved over time.
 - Perceived to have been more successful in electricity than in gas.

Negotiated settlements

- Regulated companies and consumers are able to negotiate settlements or agreements between themselves.
- In the event that an agreement is reached it is still subject to regulatory approval, which is typically given.
 - In the event that agreement is not reached, the regulator can act as an arbitrator, or, alternatively, the issue reverts to standard regulatory processes, with the regulator taking the final decision.

Negotiated settlements

- In the U.S. and Canada.
 - An alternative to formal rate-hearing process.
 - In Canada, almost all major pipelines have come to settlements since 1997.
 - In U.S., at federal level in energy, rate case settlements estimated at 90%.
 - See Wang (2004); Littlechild (2012).
 - Role for Offices of Consumer Advocate in negotiations with Public Utility Companies.
 - In the U.S., the proportion of cases settled at state level different to that of federal level.
 - Why? Littlechild (2012) conjectures that rates at state level have more direct effect on consumers and therefore may be more political.

Negotiated settlements

- Negotiate/arbitrate approach.
 - Australia: Part IIIA and Part XIC of the CCA (until 2011).
 - Also used in: UK telecommunications; water industry in England and Wales; and some parts of gas industry (storage).
 - Mainly business-to-business settlements.
- Negotiation on specific issues.
 - Public contests for new investments in electricity transmission in Argentina (see Littlechild and Skerk 2008).

Negotiated settlements

Potential benefits

- Allows consumers and utilities to reach agreement on matters that may not have been addressed through the standard regulatory process.
 - More flexible and innovative. Allows for the introduction of various new initiatives.
 - Allows parties to make trade-offs *across* the price control issues as a package: Wang (2004)
- Perceived to have introduced some aspects of RPI-X style regulation into RoR approach (Wang:2004; Littlechild:2012).

Negotiated settlements

Potential benefits

- Addresses various disadvantages associated with the standard regulator-led process.
 - Regulator's ability to represent consumers; the one-size-fits-all approach; the need for regulators to satisfy multiple objectives.
 - Can be faster and less burdensome, and can require less technical analysis.
 - Focus on the 'bottom-line'.
- Can bring real benefits for consumers in terms of rate reductions.
 - Littlechild 2008: Between 1976 and 2002, the average negotiated settlement in Florida resulted in a rate reduction of \$50 million (c.f. \$7 million for traditional rate review)

Negotiated settlements

Possible limitations

- Concerns about lack of transparency: ‘black box’ settlements.
- Dealing with customer heterogeneity.
 - Ensuring all significantly affected interests are represented in negotiations.
 - Wang (2004) found evidence that some consumers found an agreement to be inferior to that of the standard process.
 - Non-unanimous approvals: can leave some parties out of decision-making, and shift burden onto non-consenting party.
 - Florida PSC approval in 2012 of an agreement between a utility and groups (mainly large users) representing less than 1% of the utility’s customer accounts.

Negotiated settlements

Possible limitations

- Non-representation of views of future consumers?
 - May be an acceptable bargain between current consumers and utilities, but not in best interests of future consumers/citizens.
 - Deferral of costs (such as depreciation profile) onto future consumers. (e.g.: in Florida and Canada).
 - A residual role for a regulator to ‘represent’ views of future consumers?
- Limited success of negotiate/arbitrate model in some contexts
 - Australia telecommunications: over 160+ arbitrations.
 - Failure in England and Wales water sector (e.g.: Albion water)

Are the different forms of consumer involvement context-specific?

- Consult/respond and consumer panels are widely used.
- More difficult to assess the potential applicability of constructive engagement/negotiated settlements because of significant differences in institutions, principles and processes across jurisdictions.
 - Traditional U.S. approach is adversarial and trial-like. Consumers need to be represented in the ‘hearing’. Rate petitions are assessed according to judicially-established standards such as ‘just and reasonable’.
 - In contrast, the approach in Europe/Australia is more administrative. Regulators typically required to make sure decisions are consistent with a range of statutory objectives (i.e.: protect consumers, promote competition, social, environmental implications).
 - In the U.S. the regulated company typically makes the price petition, while in Europe/Australia average price levels are set for a fixed period (i.e.: five years) on the basis of forecasts.

Can negotiated settlements work outside of North America?

- Littlechild (2008) – Yes! What is principally required is a change in ‘regulatory attitude’
 - The regulator needs to make it known that negotiated settlements would be considered and encouraged.
 - Arguably, already used in Australia (under Part IIIA and in the past in telecoms) and elsewhere.
- However, approach considered by Ofgem and Ofwat, but a form of constructive engagement preferred.

Can negotiated settlements work outside of North America?

- More generally, is the applicability limited by:
 - A need to reconcile any agreed settlement with the statutory objectives of some regulators in relation to vulnerable consumers, environment etc.
 - Whether the same ‘standards’ (‘just and reasonable’ v. ‘public interest’), and level of scrutiny is applied under two processes (the formal process and informal negotiated settlements).
 - What are the incremental benefits for jurisdictions which already apply RPI-X regulation?
 - What happens when one aspect of a negotiated settlement is breached (i.e.: an agreement in relation to specific performance or quality etc.) Are these ‘regulatory breaches’ or ‘commercial breaches’?