REGULATORY NUDGES

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Is behavioural economics ‘the new black’ of regulation? There is increasing evidence of its influence on governments and policymakers. Witness the appointment of Cass Sunstein (one of the authors of Nudge) to Head the US Office of Information and Regulatory Affairs, and the creation of a ‘Behavioural Insights Team’ within the UK government. A recent Cabinet Office report espoused the potential effectiveness of the Nudge-inspired toolkit to ‘shape behaviour’, and to encourage citizens ‘into new ways of acting by going with the grain of how we think and act’.

The insights from behavioural economics have led to a re-think of how regulation is implemented across a wide range of areas, including the utility sectors. In the UK, Ofcom, Ofgem and the Office of Fair Trading have all looked at the implications of behavioural economics research for their work. A general finding of this work is that consumers have various decision-making biases, which can lead to weak consumer engagement in the market, softening the demand-side pressure necessary for effective competition. A March 2011 Ofgem report found that consumer engagement in the energy market may be impeded by complex tariff information and poor comparability between suppliers’ tariffs, which accentuate decision-making biases and lead to lower levels of consumer switching. Ofgem also concluded that consumer behaviour can be affected by the ‘status quo bias’ (consumers favouring their existing choice) and ‘loss aversion’ (consumers weighting potential losses more than gains).

Now Ofgem is consulting on retail market reform. The reforms are, in Ofgem’s own words, designed to ‘nudge consumers to engage’ with the market. The core proposal is for retail suppliers to offer only one standard tariff per payment method (which would be based on a set of standardised elements, set annually by Ofgem), and that suppliers compete on a single unit rate for each standard tariff. Suppliers can offer, and customers can opt for, non-standard tariffs, but the standard tariff will apply as ‘default’.

The changes aim to simplify the energy tariff structure and improve comparability of tariffs across suppliers. The expectation is that this will improve consumer decision-making, but potential downsides of the changes have been recognised. For example, suppliers will be prohibited from offering discounts, or linking the standard domestic supply contract to contracts for other goods and services. In particular, dual fuel tariffs would no longer be available in the standard segment of the market, despite being popular with many consumers. The treatment of ‘time of use’ tariffs, which are expected to become more prevalent with the roll-out of smart meters, is also unclear under the proposals.

Some may question whether these proposals comprise more of a ‘shove’ than a nudge. More generally, these types of proposals raise questions about the abilities and experience of regulators in designing ‘nudges’. In his recent book, Nobel laureate Daniel Kahneman warns of the risks of experts not knowing the limits of their expertise, and the dangers of the ‘planning fallacy’ in government decision-making. In attempting to correct for consumer biases and ‘shape behaviour’, regulators and policy makers might themselves be introducing their own particular biases and decision-making errors.

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INTERNATIONAL REGULATORY ROUND-UP

Communications

Americas

US: FCC Seeks Comment on Preliminary Plan for Retrospective Analysis of Existing Rules

The Federal Communications Commission (FCC) has released a preliminary plan for retrospective analysis of existing rules. The plan describes the FCC’s ongoing process of identifying outmoded or counterproductive rules and provides an overview of recent and current proceedings that include retrospective analysis. The FCC seeks comment generally on the plan, and also seeks specific recommendations on the following questions: what additional steps should the FCC take to identify rules that should be changed, streamlined, consolidated, or removed; how can the FCC further reduce burdens on industry and consumers while fostering competition, diversity and innovation; are there FCC rules or reporting requirements that are duplicative or that have conflicting requirements among its bureaus and offices or with other agencies; are there FCC rules or reporting requirements that could be modified to better accomplish their regulatory objectives. The deadline for submissions is 8 February 2012.

Europe

UK: Ofcom Extends Exemption from Undertakings for Copper DSLAM Wholesale Broadband Connections

The Ofcom has published a decision to extend an exemption from the undertakings for copper Digital Subscriber Line Access Multiplexers (DSLAMs) – wholesale technology used to provide broadband technology. This follows BT requesting that the exemption be extended from 31 December 2011 until its Next Generation Network Technology is deployed.

UK: Ofcom Publishes Draft Work Programme 2012-13

The Ofcom has published its draft 2012-13 annual plan for consultation. The plan outlines the Ofcom’s proposed priorities for the year: promote effective and sustainable competition; promote the efficient use of public assets; help communications markets work for consumers; provide appropriate assurance to audiences on standards; and contribute to and implement public policy defined by Parliament. The deadline for submissions is 17 February 2012.

Ireland: ComReg Publishes Consultation on New Licensing Framework for VHF and UHF Telemetry Systems

The Commission for Communications Regulation (ComReg) has published a consultation on a range of proposals to establish a new licensing framework for scanning telemetry and telecontrol systems in the VHF and UHF spectrum bands. A telemetry and telecontrol system (telemetry) is a wireless telegraphy system by which automated measurements are made and other data collected at remote or inaccessible locations, and transmitted to receiving stations for monitoring, recording or remote control purposes. The ComReg currently licenses telemetry under its Business Radio licensing framework, which is intended to facilitate mobile services. However, with the increasing demand for telemetry, which is a fixed wireless service, it has become difficult to provide interference-free channels for this purpose. Furthermore, the incompatibility of fixed and mobile users requires that significant tranches of spectrum are left unused to serve as guard-bands between these two user groups. The ComReg considers that a licensing framework specifically for telemetry is required in order to meet the demand for
spectrum and to ensure ongoing coexistence with other services. This consultation proposes four new licence types that are aimed at meeting the needs of different telemetry users, ranging from systems spanning a single premises to regional and nationwide networks. The new licences will also include a revised fee-structure and licence conditions appropriate to telemetry use. The deadline for submissions is 27 January 2012.

Energy

Europe

CEER Announces Final Advice on Regulatory Oversight of Energy Exchanges

The Council of European Energy Regulators (CEER) has announced the publication of its final advice on the regulatory oversight of energy exchanges. The final advice addresses the organisation and the regulatory oversight of energy exchanges (that is, the supervision of energy exchanges and the monitoring of trading activities of market participants by the competent authorities) and describes the CEER’s findings from best-practice examples. The advice may thus serve as a background paper, which may be utilised in parallel to the further discussions on the implementation of Regulation for Energy Market Integrity and Transparency (REMIT).

Germany: Bundesnetzagentur Determines Quality Element for Electricity Distribution Systems

The Bundesnetzagentur (‘Federal Network Agency’) has determined the level of the quality element (Q-element) for the electricity distribution system operators participating in the regular incentive regulation procedure in the first regulatory period. The level of the Q-element depends on the reliability of the relevant system. System operators whose network has had good quality levels relative to other system operators over the past few years will have an amount added to the revenue cap for the years 2012 and 2013, while operators whose networks have comparatively poor quality levels will have amounts deducted. Out of a total of 202 system operators, 143 will have an amount added (bonus) and 59 an amount deducted (penalty). The level of the bonus or penalty an individual company receives is primarily based on the difference between the individual reliability of the electricity network during the period 2007 to 2009 and a reference value calculated for this period. The other major factor is the economic cost of outages and the number of end users supplied. The indices of 207 electricity distribution networks were included in the calculations to determine the reference values for low and medium-voltage. Structural differences between the individual network areas were shown using load density as a parameter. In order to minimise the financial risks for system operators posed by major fluctuations in supply outages, bonuses and penalties will be symmetrically capped for 2012 and 2013. In addition, the system aims to achieve revenue neutrality, meaning that the totality of all bonuses and penalties are offset across all system operators.

Germany: Bundesnetzagentur Publishes Monitoring Report 2011

The Bundesnetzagentur has published its Monitoring Report 2011 (in German), which documents and analyses developments in the fields of generation and transport (networks), and wholesale and retail markets. A key finding of the report is that the number of final consumers who switched their power or gas supplier rose markedly in 2010. The report also discusses the progress of grid expansion, developments on the power market and developments on the gas market.
Northern Ireland: Utility Regulator Publishes Phoenix Supply Ltd Price Control Determination

The Northern Ireland Authority for Utility Regulation (Utility Regulator) has published its determination paper on the Phoenix Supply Ltd price control. The determination details the treatment of each element of the Phoenix Supply Ltd tariff for the period of the control. The price control will last for five years, from 1 January 2012 to 31 December 2016. This decision paper follows the publication of the Utility Regulator’s minded to position in June 2011. The Utility Regulator received four responses for this paper: Phoenix Supply Ltd, firmus energy, Power NI, Consumer Council for Northern Ireland.

Northern Ireland: Utility Regulator to Increase Domestic Electricity Switching Capacity

The Utility Regulator has approved and agreed with Northern Ireland Electricity (NIE) that the current interim market system and supporting arrangements for domestic electricity-switching are capable of dealing with an increased number of switches (churn capacity) per month from the current limit of 7,500 to 10,000 (from 1 December 2011). The overall switching limit ceiling capacity of 125,000 was also reviewed, and it was agreed to increase this ceiling to 140,000 following improvements made to the system. The recent review follows an Interim Market Arrangements paper (prepared in August 2009) in which the Utility Regulator noted that, when a new supplier entered the market, the switching limits would be kept under review to assess if there were any opportunities to increase the switching capacity. The Utility Regulator and NIE will continue to review both the overall and monthly switching limits and also the allocation between keypad and credit switches (including apportionment of the available capacity among suppliers). The long-term solution (also known as the Enduring Solution), which is due to be implemented in May 2012, will replace the current interim system and will deliver unconstrained domestic customer switching.

UK: Ofgem Consults on Transmission Investment Incentives Framework

The Ofgem has published a number of consultation documents relating to the Transmission Investment Incentives (TII) framework. The first consultation sets out the Ofgem’s policy decisions on the TII framework to apply in 2012-13. The second relates to the Ofgem’s initial drafting of the proposed licence changes to extend the TII framework into 2012-13, in line with the decisions set out in the Ofgem’s November 2011 policy decision document.

UK: Ofgem Issues Gas Distribution Networks’ Business Plans

The Ofgem has issued the gas distribution network (GDN) companies’ RIIO-GD1 business plans for stakeholder feedback. The next GDN price control (RIIO-GD1), along with the transmission price control (RIIO-T1), are the first price controls to be conducted under the new RIIO model. The Ofgem is seeking submissions on the overall quality of the plans, whether they reflect what customers value, the expenditure proposals, the financial proposals and how they deal with uncertainty and risk. The Ofgem will publish its initial assessment of these plans in March 2012. The deadline for submissions is 20 January 2012.

UK: Ofgem Launches Renewable Heat Incentive

The Ofgem has launched the Renewable Heat Incentive (RHI), a financial incentive scheme for renewable heat generation aimed at helping the UK reduce carbon emissions and achieve its EU renewable energy targets. The launch begins with Phase 1 of the RHI scheme opening for
applications. Phase 1 supports generators in non-domestic sectors with eligible installations, and producers of biomethane. Although domestic installations are not included yet, in the interim, they may be eligible for the Renewable Heat Premium Payment (RHPP).

**UK: Ofgem Publishes Final Proposals for Transmission Price Control Review 4 Rollover**

The Ofgem has published its final proposal on the price-control extension for the four transmission licensees, along with National Grid in their role as the system operator of the gas and electricity transmission systems. The current gas and electricity transmission price controls (TPCR4) expire on 31 March 2012. To enable the next price controls to reflect fully the new RIIO model for regulation, the Ofgem previously announced its decision to delay implementation of the new price controls until 1 April 2013. Therefore it will implement a one-year rollover of the existing price controls to operate in the period 1 April 2012 to 31 March 2013. The allowances for the rollover year have been reviewed in the light of the recent RIIO business plan submissions. The Ofgem considers that its approach strikes an appropriate balance between its principal objective to protect existing and future consumers and the need for a review proportionate to a one-year control. The licensees had until Friday 16 December 2011 to accept Final Proposals.

**UK: Ofgem Reviews Low Carbon Networks Fund**

The Ofgem is undertaking a review of the Low Carbon Networks (LCN) Fund following two years of operation. In the Distribution Price Control Review 5 (DPCR5) final proposals it stated that there would be a review after two years to assess whether the design of the LCN Fund was delivering its intended objectives. The consultation letter sets out the areas the Ofgem is considering in the review, and invites views ahead of a decision in early 2012. The deadline for submissions is 11 January 2012.
approval comply with the requirements of the price-cap mechanism.

**Ireland: ComReg Publishes Quality of Postal Service Monitor 2011**

The Commission for Communications Regulation (ComReg) has published the Quality of Postal Service Monitor for 2011, which covers items posted on or between 1 January 2011 and 30 September 2011. The report, produced by Ipsos MRBI (commissioned by the ComReg), monitors the quality of postal service in the Republic of Ireland. The report shows that targets generally were not met, and that service has slightly decreased since last year. The report finds a decrease of one percentage point in the Next Day Delivery of single piece priority mail, compared to the annual result 2010 and compared to the same period in 2010, which now stands at 84 per cent – ten percentage points below the ComReg’s target for Next Day Delivery of 94 per cent. Also, 98.5 per cent of single piece priority mail was delivered within three working days of posting, against the ComReg’s target of 99.5 per cent.

**Rail**

**Europe**

**UK: ORR Publishes Latest Network Rail Monitor**

The Office of Rail Regulation (ORR) has published the Network Rail Monitor for 2011 Quarter 2 (24 July to 15 October 2011). The report provides an overview of the company’s performance each quarter, highlights that: punctuality for long-distance train services is now 88.7 per cent – well short of the 90.9 per cent required for 2011-12. In real terms, this means that 13,783 trains out of 125,975 planned services were over ten minutes late arriving at their destination. Delays per incident have risen, showing that the network has become less resilient to disruptions. Delays to freight services remain much worse than the target. As a result of continued deterioration in performance, the ORR is currently considering whether Network Rail is in breach of its licence and will be making a decision on potential enforcement action shortly. The report also highlights the work that Network Rail and the rail industry have been doing to prepare for potential adverse winter weather conditions, as well as for the planned engineering works on the network over Christmas and New Year. The ORR’s monitoring and inspections show that the industry has learned important lessons from the last three winters when transport was affected by winter conditions. In advance of the Christmas and New Year engineering works, the ORR has reviewed Network Rail’s plans and is satisfied that it is continuing to follow the improved processes implemented in response to the ORR’s enforcement action following the 2007-8 engineering overruns.

**Water**

**Europe**

**Northern Ireland: Utility Regulator Publishes Annual Assessment of NI Water**

The Northern Ireland Authority for Utility Regulation (Utility Regulator) has published its independent assessment of how Northern Ireland Water Limited (NI Water) has performed during 2010-11. The Utility Regulator’s Cost and Performance Report on NI Water identifies continuing progress by the water company. During 2010-11 NI Water exceeded its operational efficiency targets by £6 million, achieved its highest ever level of drinking water quality, performed favourably against sewage quality outputs and improved its Overall Performance Assessment (OPA) score – a benchmark used to compare the performance with water companies in Great Britain.
ACCC Issues Draft Final Access Determination for Regulated Transmission Services

The Australian Competition and Consumer Commission (ACCC) has issued a draft final access determination (FAD) for the declared domestic transmission capacity service (DTCS). The DTCS is a high-capacity wholesale transmission service which is an essential input for a range of communication services to end-users, and it is important that access to the DTCS is available on reasonable terms. The price terms of the draft FAD are based on a domestic benchmarking approach using a linear regression model. The model uses prices on competitive routes to predict the prices that would be expected for declared routes if these routes were priced competitively. This is the first time the ACCC has determined price terms for the DTCS using an advanced statistical model. The ACCC considers that this pricing approach reflects the complex relationships between the different factors affecting the price of transmission services. The draft DTCS FAD also includes non-price terms of access and proposes an expiry date for the FAD. The deadline for submissions on the draft DTCS FAD is 27 January 2012. The ACCC will seek to issue the final DTCS FAD by the end of February 2012.

ACCC Publishes Draft Final Report and Draft Service Description on Local Bitstream Access Service

The ACCC has published the draft final report and draft service description that will be the basis for the declared service when amendments to the Competition and Consumer Act 2010 and Telecommunications Act 1997 commence in 2012. The local bitstream access services will be used to carry digital data on superfast telecommunications networks. The amendments to the Act require that the ACCC declare a Layer 2 bitstream service. This service will be called the local bitstream access service. The declaration will mean that wholesale providers of Layer 2 bitstream services that are superfast carriage services will have to provide access to those services to retailers under the standard access obligations in the Competition and Consumer Act. It will not apply to the National Broadband Network (NBN) or to wireless or satellite networks. The deadline for submissions on the service description and report was 8 December 2011.

ACCC Receives Revised Structural Separation Undertaking from Telstra

The ACCC has received a revised structural separation undertaking from Telstra. The undertaking contains substantial revisions and additional commitments that Telstra has made in order to address ACCC and industry concerns about equivalence and transparency. However, the ACCC states that there are still some outstanding regulatory concerns in relation to wholesale ADSL services. The ACCC is now giving urgent consideration to initiating a public inquiry into declaration of wholesale ADSL under Part XIC of the Competition and Consumer Act 2010. In addition, the ACCC will shortly be finalising its inquiry into varying the exemption provisions in the final access determinations for the Wholesale Line Rental (WLR), Local Call Service (LCS) and Public Switched Telephone Network Originating Access (PSTN OA) services. Provided that the outstanding concerns around wholesale ADSL can be quickly resolved, the ACCC is otherwise minded to accept the undertaking, subject to any new issues of real substance or drafting matters arising in the course of this final round of consultation. The ACCC will issue a discussion paper relating to the undertaking shortly.
consultation period will close in mid-January 2012 and the ACCC intends to make a final decision on Telstra’s undertaking in February.

Energy

AEMC Publishes Assessment of the Impact of the Enhanced Renewable Energy Target on Energy Markets

The Australian Energy Market Commission (AEMC) has provided an updated interim report and a final report to the Ministerial Council on Energy (MCE). The interim report and final report include modelled outcomes out to 2020 for both components of the enhanced Renewable Energy Target (RET) – the Large Scale RET and the Small Scale Renewable Energy Scheme. These reports follow the MCE requesting advice from the AEMC on the impact of the enhanced RET on energy markets. Specifically, advice was requested on the impact of the enhanced RET on: the price of electricity for retail customers; the level of emissions; and the security and reliability of the electricity supply. Both of these reports and supporting consultant reports have now been published.

AER Issues Draft Determination on Aurora Energy

The Australian Energy Regulator (AER) has released a draft determination on Aurora Energy’s regulatory proposal for the Tasmanian electricity distribution network for the period 1 July 2012 to 30 June 2017. The AER has not agreed with Aurora’s forecast of costs for this period, and as a result has reduced the allowed revenue for Aurora. The AER’s draft determination would result in no average increase to a typical residential electricity bill. Aurora’s proposed increases in revenue would have resulted in an average annual 2.1 per cent increase in a typical residential bill. These increases in revenue were based on Aurora’s forecasts of its operating and capital costs including a rate of return. The most significant driver of the difference between Aurora and the AER’s position is the allowance for the rate of return. Current market conditions have led the AER to estimate a lower risk-free rate than estimated by Aurora at the time it submitted its proposal, and the AER has also adopted different values for the cost of equity and the cost of debt, which has also contributed to a lower rate of return. The AER will update the estimates of financial parameters when it makes its final determination. The AER also has lower expectations of operating and capital costs over the five-year forecast period. Aurora proposed forecast capital and operating expenditure at similar levels to its current expenditure. The AER considered that this was more than necessary under the legislative requirements. Aurora can now provide a revised regulatory proposal responding to the AER’s draft determination. The deadline for submissions is 20 February 2012. The AER will make a final determination on Aurora’s regulatory proposal in April 2012.

AER Issues Draft Decision on Powerlink's Electricity Transmission Network Proposal

The AER has issued its draft decision on Powerlink's proposal to operate the Queensland electricity transmission network for 1 July 2012 to 30 June 2017. For the five years to 30 June 2017, Powerlink sought total revenue of $5,954 million, based on its forecast operating and capital costs, including a rate of return on assets. The AER has not accepted Powerlink's forecast costs for this period and has set revenues of $4,563 million, or 23 per cent below Powerlink's proposal. Based on the AER's decision, Queensland residential power bills are estimated to increase by a total of $1.40 per year. The most significant driver of the difference between the AER and Powerlink's position is the allowance for the rate of return. Conditions in the financial markets have eased since Powerlink submitted its proposal and this has led the AER to estimate a lower base rate
than Powerlink. Further, the AER has adopted different values for the cost of debt. The financial measures will be updated closer to the time of the final decision. The AER also has lower expectations of capital and operating costs over the five-year forecast period, partly driven by lower forecasts of electricity demand growth. The AER’s analysis indicates peak demand is likely to be about 10 per cent lower than proposed by Powerlink in 2016-17. The lower estimate of demand means that Powerlink should be able to defer approximately 16 per cent per cent of its proposed capital works. In addition, the AER was not satisfied that Powerlink has adequately justified the need for all aspects of its capital works and has reduced Powerlink’s proposed capital expenditure by an additional 13 per cent. The AER also reduced Powerlink’s operational expenditure forecast by 8 per cent, citing lower forecasts for escalation in labour costs. The AER considers that the draft decision represents a reasonable assessment of the efficient costs of providing the transmission services, and that the forecasts provide sufficient for network investment to keep pace with growth in peak demand and to meet reliability requirements. Powerlink can submit a revised regulatory proposal to the AER by 16 January 2012. The deadline for submissions is 20 February 2012.

## Water

### ACCC Issues Revised Guide on Water Termination Fee Rules

The ACCC has issued a revised guide that aims to better inform irrigators and irrigation infrastructure operators about their termination fee rights and obligations. As a result of feedback from industry, the revised guide includes more information about the requirement for a written notice of termination. The guide also provides more details on how to calculate the total network access charge, which is a key concept in determining the maximum permissible termination fee. The Water Act 2007 provides the ACCC with powers to enforce compliance with the Water Charge (Termination Fees) Rules 2009 and other water rules. As part of this role the ACCC provides guidance to operators and irrigators to assist them to understand when operators are permitted to charge termination fees and how to calculate the maximum permissible termination fee. Operators may be entitled to charge terminating irrigators a fee but, if they do so, they need to ensure that they have met the requirements of the rules, including not exceeding the maximum permissible termination fee. The ACCC also monitors termination fees imposed by operators and reports on industry trends in its annual monitoring report. The 2010-11 monitoring report is due out in April 2012.