

RPI-X@20 stakeholder workshop – 6 April 2009

Summary of break-out session discussions

What role should the consumer take in the regulatory process?

Introduction

Two RPI-X@20 workshops were held in London on 6 April – one in the morning and one in the afternoon. The purpose of the workshops was to facilitate discussion on the initial consultation document regarding RPI-X@20 which was published in February. It was also intended to allow an exchange of views between interested parties over the issues that would need to be explored within the project going forward. This was achieved through the use of break-out sessions.

The topic for one of the break-out sessions was the role of the consumer in the regulatory process. To facilitate an exchange of views on this topic, the group were given a set of guiding questions. A summary of the discussions that took place on this topic during the morning and afternoon sessions is provided below.

Summary of Morning Break-out Session Discussions

- The group was tasked with a discussion regarding the role of the consumer in the regulatory process but they considered that the focus of discussions should be the role of the consumer in the process of regulating the networks since RPI-X is used in network regulation not other areas such as supply (supplier issues such as price and ease of switching are usually of higher or more direct relevance to consumers).
- **Focus on consumers:** A discussion took place around whether there should be greater focus upon the consumer as part of the determination of the regulatory settlement for the network companies and there was a feeling that there should be continued focus on consumers by both Ofgem and the network companies. Although it was recognised that Ofgem is doing a lot to accommodate the end consumer in the regulatory process, a view was expressed that there is a continued need for engagement with, and empowerment of the consumer. However, some felt that Ofgem's focus in this area is on switching as consumers have a greater concern about issues in this area and therefore have less interest in the issues associated with network regulation. In this regard, it was suggested that it may be relatively more difficult to engage consumers on network issues, with reference made to the fact that consumers wanted to pay a fair price for energy and had less concern about transportation issues. The difference in consumer engagement, whereby the needs of consumers are sought to be understood, and consumer focus, which would place consumer interests at the forefront of regulatory decisions, was noted.
- **The consumer:** The group considered the question of who the consumer represented and which consumers should receive focus within the regulatory regime. There was a consensus that suppliers should not be thought of as 'customers' of the networks in the regulatory process. This was because the interests of end users and suppliers are not aligned. The different categories of end user were recognised as

comprising Industrial & Commercial customers and domestic customers, with the possibility that both of these could be thought of in terms of current and future consumers. The group recognised that domestic customers could also be broken down further into other user groups, including vulnerable customers. They noted that, politically, it was likely to be considered more important to secure engagement with these customers.

- **Areas of engagement:** There was a discussion about areas of potential engagement with consumers. Within this discussion, there was a recognition that the balancing of priorities currently sits within Ofgem and that Ofgem seeks to integrate the views of the various parties with an interest – including consumers. The environment was identified as an externality and there was a feeling that if consumers took decisions on the regulatory regime, there would be a lower willingness to pay for investment required to meet environmental targets. In contrast, a suggestion was made that if consumers had more information about the regulatory regime and the pros and cons of moving to a low carbon economy, they would be able to make a more informed decision regarding these types of issues.

It was noted that areas of engagement would need to be different for different types of customers and may need to be different depending on region, with a member of the group noting big variations in the views of rural and urban consumers.

- **Achieving effective engagement:** A key question on effective engagement and the way it might be achieved was discussed, which led to a discussion about alternative models that may be appropriate. It was suggested that, if consumer engagement were to be meaningful, it would be important for the consumer to be allowed to think about the big questions, for example, network investment. Reference was made to the models written about by Stephen Littlechild in which deals with consumers were reached via negotiation between the consumers' representatives and the utilities. It was noted that this might not be a first best solution but the debate highlighted the key distinction between mechanisms that sought to ensure a better understanding of the preferences of consumers and mechanisms that were more radical in that they gave consumers the power, subject to the approval of the regulator, to reach deals with network companies. The more radical step would raise significant issues of governance (i.e. who would be empowered to represent which categories of consumer?) It would also require that the consumer bodies would have to become sufficiently expert in the regulatory, financial and engineering issues that arise at conventional price control reviews. It was noted that the body(ies) representing consumers would probably have to acquire many of the staff who presently work for Ofgem. The less radical step would require only that the price control review process is more attuned to the expressed preferences of end users who are explicitly not required to become expert in the matters that are determined at price controls.

It was considered important to educate customers that increases in investment would lead to increased costs for them. Reference was made to the approach adopted in Queensland, Australia where the regional councils had engaged in an extensive period of consultation. However, there had been ten years of underinvestment and, coupled with an increase in demand, this had led to a growing desire for an increase in investment. Although investment was an area of engagement with consumers, the issue of price was not discussed and, as a result, the long process of consultation was not successful.

It was recognised that although Ofgem is considered a proxy for the consumer voice it has other duties and, coupled with this, is not close enough to the consumer to represent their views. Therefore it was suggested that, if consumers are a key player in the regime, it would be important to appoint a party with expertise in this area to negotiate on their behalf. However a member of the group pointed out that consumers were only one of a number of different stakeholders and therefore their views would need to be balanced against others.

The group identified two alternative models that could be used:

1. Continuation of the existing arrangements with Ofgem taking greater account of the consumer dimension; or
2. Placing consumer engagement as the focal point of the process, with the party responsible for negotiating with the network companies having direct responsibility for this.

A mid-way point between these alternatives was considered difficult as it would give consumer representatives power without corresponding accountability. The group did not consider that consumer representative bodies would currently be adequately resourced to assume this responsibility. It was noted that in the US example, staff had been transferred from the regulatory body to the consumer advocacy body. It was pointed out that the representative body would not be able to voice the views of all consumers but rather would act as a consumer advocate. The group noted that Ofgem could not perform this role due to the constraints of its other statutory duties.

It was recognised that there were other ways to get more consumer involvement as, at the moment, there is no formal role for the consumer representative and, due to their lower resource, they are less able to engage through consultations.

Another suggestion was that Ofgem could set out that it would not be willing to agree a regulatory settlement without the agreement of certain consumer bodies.

However, this might raise legal issues related to the fettering of Ofgem's discretion that is not permissible under the current legal arrangements.

- **Process of appeal:** A discussion took place on the process of appeal and the role that consumers should play within this. It was noted that the Secretary of State has the power to veto regulatory settlements and that, if consumer representatives had significant concerns about the package put in place, it would be possible for them to lobby the secretary of state to request that the proposed modification by agreement be referred to the Competition Commission (CC). Members of the group saw difficulties in giving consumers a formal power of veto with respect to price controls as there would be no real prospect of a downside for them of forcing a CC enquiry.
- **Timetables:** In terms of the impact that the process of consumer engagement may have on the regulatory timetable, it was noted that, if consumers were to have meaningful place in shaping the outcome of a price control review, under some approaches, there would need to be a period of education for consumers before fully effective consumer engagement could be achieved. It was suggested that this could take anywhere from three to five years and would involve the development of new arrangements for consumers. However, under other models of consumer engagement no particular education was necessary since the purpose of the

engagement was to ascertain the raw, untutored preferences of ordinary consumers, rather than to make them expert in the processes of regulation.

Summary of Afternoon Break-out Session Discussions

- **Focus on consumers:** A discussion took place around whether there should be greater focus upon the consumer as part of the determination of the regulatory settlement for the network companies. A point was made that GDNs had a history of engaging with consumers with reference made to the gas customer forum which provides an opportunity for customers and GDNs to discuss their views. It was suggested that these arrangements may have been implemented due to structural changes in the gas network as well as the arrangements in gas e.g. interruptions, which mean that the GDNs need to have direct contact with their consumers.

A point was made that historically Ofgem's focus on consumers has been relatively low but that this had improved with the establishment of the consumer challenge group and the consumer first panel. While engagement was better there were always going to be ways in which it could be improved.

Aside from questions on whether the network companies engage consumers, there were questions about whether they seek to serve the system. As such, it was noted that the networks are not focussed on serving the market but rather on Ofgem.

An example of the lack of consultation was noted with respect to the structure of charges where there is no consultation with either consumers or other market players and this is closely aligned to the price controls.

- **The consumers:** The group considered the question of who the consumer represented and which consumers should receive focus within the regulatory regime. It was felt that Ofgem would need to get different levels of consumer buy-in and it would need to positively manage this within the framework utilised. However, a point was made that there was a greater role for involvement of transmission consumers rather than consumers of the distribution companies.

A question was raised as to why suppliers, as a middle-tier customer, should be involved in the process, when they would simply pass costs onto their consumers. In response, it was noted that not all of the costs would be passed through. Suppliers wanted to deliver value for money but did not have visibility on the level of their bills.

A few group members considered that shippers and suppliers could not be used as a proxy for the consumer view with the example of the pool highlighted. In this case, RECs had been used to represent consumers views but, while consumers were worried about pool prices, the intermediaries were more concerned about uplift.

The role of the government was raised and whether it could be thought of as another customer of the networks given its role in setting policies especially as changes in policy direction can impact on the extent to which networks focus on the customer.

- **Barriers to engagement:** A discussion took place regarding the barriers to effective consumer engagement that currently exist within the regulatory regime. The group considered that complexity can act as a barrier to engagement but that there may

also be issues associated with the incentives to engage. It was suggested that the system users are generally likely to be more interested.

The group highlighted the role of consumer focus in representing domestic customers but had concerns that they had limited knowledge and budget as well as too many areas of the regime to concentrate meaning that their input could not be targeted. A question was raised as to whether, if Ofgem spent more time obtaining views from consumer reps this would improve their ability to respond to consultations. However, limited resources and funding were raised as issues which limit their engagement. Reference was also made to the significant volume of paperwork that is involved in the price control process which acts as a significant barrier, although one that could be reduced somewhat by providing parties with sufficient time to prepare responses.

- **Achieving effective engagement:** The question of effective engagement was raised, which led to a discussion about alternative models that may be appropriate, with particular reference made to CAA's use of constructive engagement. In taking this model forward, the CAA had recognised that, on a broad range of issues the airlines could be considered a proxy for the views of consumers. Where it was possible for BAA and the airlines to reach agreement on certain issues, CAA was likely to place significant weight on this agreement, although it reserved the right not to. The Constructive Engagement process was set up with certain issues (cost of capital, commercial revenues) out of scope due to confidentiality or the "zero-sum" nature of negotiations. These issues were subject to more traditional regulator-led analysis and consultation. The group recognised the merits of constructive engagement and one member noted that the consumer challenge group could provide a suitably informed group to perform this role.

One potential learning point from constructive engagement was the need to have processes in place to control the sharing of information, if supplier-customer negotiation proves to be inadequate. A question was raised as to whether constructive engagement had led to increased gaming and the under-delivery of capex. It was noted that, the CAA deployed a set of "triggers" (performance incentives linked to the completion of project milestones) that meant that if key outputs were not delivered there would be a reduction in capex allowances.

The group noted that process management would be needed as the networks were unlikely to be proactive and therefore the process would likely require close involvement by the regulator.

- **Process of appeal:** The role that consumers could take in the appeal process was discussed and the group recognised that the majority of the burden of any appeal to the regulatory framework would be borne by the network company rather than the consumer body. There was a concern that as there would not be a financial burden on the customer from appealing, it may be more appropriate for a consumer body, such as the challenge group, to have the right to appeal as the understanding of the issues and the reasons for the policy approach would be better understood. A point was made that the risk of appeal could generally be lower where consumers were engaged in the process and therefore this might provide incentives on the network companies to progress greater consumer engagement earlier in the process.

- **Timetables:** In terms of the impact that the process of consumer engagement may have on the regulatory timetable, there was a feeling that consumers would need to be involved in setting up the process and that they would need to be revisited at points in the process when new information came to pass. A point was made that, given the price controls are revisited every 5 years and training of the consumer reps might be needed, it would almost be necessary for the engagement to take place on a continuing basis. A point was also made that intervening issues would arise on which DNOs do not currently engage consumers and it was therefore suggested that the engagement could take place every six months.