Consumer involvement, ex post regulation and customer appeal mechanisms

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1. Background

Ofgem's RPI-X@20 review is a 'root and branch' review of energy network regulation in Britain. A major element has been the nature and extent of customer involvement in the regulatory process.[1] Further questions relate to the use of ex ante or ex post regulation, and to the possibility of customer appeals against Ofgem's price control proposals. Ofgem asked LECG to review these two issues, and it has recently reported.[2] Others have also contributed on the customer appeal issue, notably John France and CEPA.[3] (These papers are all available on the Ofgem RPI-X@20 website. For convenience, the last four papers are summarised in an Annex to the present paper.)

LECG1 looks at a spectrum of types of regulation, ranging from ex ante to ex post. It ranks ex ante regulation and two representative ex post regimes (thresholds and competition policy) against five criteria. Ex ante regulation scores much more highly than either. LECG1 concludes that there do not appear to be benefits to customers in moving from ex ante to ex post regulation.

LECG2 considers whether energy consumers and network users should have a right to appeal against Ofgem price control decisions to the Competition Commission (CC). It finds that such appeal rights would have significant benefits, that the direct costs of appeals would not be significant and that the indirect costs (added uncertainty) could be mitigated through careful design of the appeals process. It recommends that appeal rights should be extended to consumers and users.

If customers (and others) have a right to appeal to the CC against Ofgem decisions, what does this mean for the future role of Ofgem? John France argues that Ofgem

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[1] Ofgem earlier requested a review of some alternative approaches adopted elsewhere. Stephen Littlechild and Nigel Cornwall, *Potential scope for user participation in the GB energy regulatory framework, with particular reference to the next Transmission Price Control Review*, 27 March 2009.

[2] LECG, *The case for ex post regulation of energy networks*, 7 October 2009 (henceforth LECG1) http://www.ofgem.gov.uk/Networks/rpix20/forum/for/Documents1/Final%20report%20ex%20post%20regulation.pdf; LECG, *Should energy consumers and energy network users have the right to appeal Ofgem price control decisions? If so, what form should the appeals take?* 7 October 2009 (henceforth LECG2) http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Documents1/Right%20of%20Appeal%20Final.pdf .

[3] John France, *Consumers, stakeholders and appeal mechanisms in the regulation of energy networks*, 23 September 2009 http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Documents1/Consumers,%20Stakeholders%20and%20Appeal%20Mechanisms.pdf . CEPA, *Consumers' right to appeal regulatory decisions*, report to Centrica, 14 October 2009 http://www.ofgem.gov.uk/Networks/rpix20/forum/rocag/Documents1/Centrica%20paper%20right%20of%20appeal.pdf .

would no longer continue to have a significant role in the price control process, and would simply be a mediator between the parties. He also argues that environmental considerations would have less weight in price control decisions. In the light of this, he seems to conclude against a consumer right of appeal. CEPA argues that the role of Ofgem would not be weakened, and concludes in favour. LECG2 does not address this issue.

These three contributions to the debate represent three possible developments in GB regulatory policy.
- Policy 1 (broadly John France's position?) is to retain the present ex ante approach, possibly with a greater emphasis by Ofgem on consulting customers, but with no decision-making power for customers and no customer appeal rights.
- Policy 2 (broadly LECG's position) is to retain the present ex ante approach, but to add customer appeal rights.
- Policy 3 (broadly CEPA's position) is to move towards a greater role for customers and users in negotiating with companies, with ex ante and ex post options as complements rather than as substitutes, and, in the event of failure to agree, a right of customer appeal to the CC.

In terms of the questions whether they support a move to ex post regulation and a right of consumer appeal to the CC, the three policies mentioned above answer as follows. Policy 1: No, No; Policy 2: No, Yes; and Policy 3: Yes, Yes.

Logically, there must be a Policy 4 embodying the answers: Yes, No. This paper suggests that there is merit in further consideration of such a policy.

2. Summary of this paper

LECG1 lists as one ex post regime the policy now used to regulate Australian airports. (It is variously referred to as light-handed regulation, threat of regulation, price monitoring, information disclosure and obligation to negotiate – I shall often refer to it simply as Australian airport regulation.) LECG1 gives a brief case study and some assessment, but does not formally evaluate this regime along with the others. However, based on LECG1's description of this regime, it would seem to score nearly as highly as ex ante regulation.

There is an apparent tension between the two LECG papers. LECG1 argues that the great strength of ex ante regulation is that it prevents excessive pricing, yet LECG2 sees the main case for consumer appeal rights as providing significant benefits to customers by improving the outcome of price control determinations. This casts doubt on the high score given to ex ante regulation in terms of protecting customers. If a slightly more moderate mark is given to ex ante regulation on this criterion, then ex ante pricing and ex post regulation (Australian airport style) are on level pegging.

A companion paper[4] gives a more detailed account of Australian airport regulation than was possible within the confines of LECG1. It highlights the role of ex ante regulatory guidance, the emphasis on commercial negotiations between airports and airlines, and the availability of a dispute resolution procedure. In the light of this reassessment, ex

[4] Stephen Littlechild, "Light-handed regulation of Australian airports", 29 November 2009.

post regulation (Australian airport style) scores more highly against LECG1's own criteria than does ex ante regulation. It has additional benefits, not covered by LECG1's criteria, in terms of encouraging better information flows and customer relationships within the industry.

An ex post regime of this kind would create a de facto right of both sets of parties to appeal to the regulator Ofgem in the event of failure to reach agreement, but not (at this stage) a formal right of consumer appeal to the CC. I suggest that this would be a more efficient use of Ofgem and the CC, and would achieve the kind of 'culture change' sought by proponents of customer appeal, but would not require a change in legislation.

3. LECG on Australian airport regulation

LECG1 looks at a spectrum of types of regulation, ranging from ex ante to ex post. It then appraises these various regimes against five criteria. It focuses on a thresholds regime and a competition policy approach as representative examples of an ex post approach. Its Table 1 gives scores to ex ante regulation and to these two ex post regulation regimes against each of the five criteria. The scores range from three ticks to three crosses.

LECG1's Table 1 ranks thresholds the same as ex ante regulation with respect to regulatory burden, and worse on the other four criteria. It ranks competition policy slightly better than ex ante regulation on two criteria (investment and innovation, and regulatory burden), slightly worse on two other criteria (operating efficiency and regulatory process), and very significantly worse on protecting consumers by preventing excessive pricing. LECG1 concludes that there do not appear to be benefits to customers in moving from ex ante to ex post regulation.

LECG1 earlier identifies as one possible ex ante regime the approach taken in regulating Australian airports. It summarises rather succinctly the nature and experience of this approach. (section 5.7) There was initially a period of CPI-X price caps. Then, following a review by the Productivity Commission (PC), "the new system adopted a monitor, review and sanction approach". "There is no formal price threshold determination of ex ante determination of the approach to airport costs. However, airlines are required to disclose cost information and the ACCC (Australian Competition and Consumer Commission) does monitor prices, costs and profits." (para 5.109) If the review determined that an airport had performed unsatisfactorily, it could recommend the imposition of ex ante regulation. (Hence the policy is sometimes referred to as embodying the threat of regulation.) In addition, airports would be subject to general competition regulation, including Part IIIA of the Trade Practices Act, which governs access to essential services.

On this basis, LECG1 places Australian airport regulation towards the competition law end of the ex ante ex post continuum, rather than towards the ex ante end.

LECG1's Table 8 summarises its assessment of Australian airport regulation against its five criteria. However, LECG1 does not then score this regime in terms of ticks and crosses against its five criteria. We therefore seek to assess what marks LECG would have given on this basis, against LECG1's criteria and using what appear to be LECG1's own judgements.

- Preventing excessive pricing: LECG1 comments "some restraint but it is likely that prices are above cost". In terms of LECG1's overall assessment of other regimes, this implies that it might deserve one tick: better than a competition policy regime, comparable to a thresholds regime, but not as satisfactory as ex ante pricing.

- Efficient and timely investment: "It is easier for airports to invest. Unclear whether investment would be different under ex ante regulation." The regime is thus better than Australian price caps, not obviously more or less efficient than ex ante price control, but should have some of the incentive advantages of a competition policy regime (which gets two ticks). This suggests (conservatively) one tick, as for ex ante price controls.

- Operating efficiency: "Productivity is high, indicating operating efficiency." This implies two ticks, as for ex ante control.

- Regulatory burden: "Regulatory burden is relatively low, although some scope for arbitration." This implies one tick, comparable to a competition policy regime.

- Regulatory certainty and transparency: "Regulatory threat is dependent on monitoring and regular review by the Productivity Commission. Process appears to be workable, though airlines clearly concerned by the process." This appears to be comparable with the assessment of a competition policy regime, which gets one tick.

Inserting this into LECG1's Table 1, the overall assessment looks as in Table 1*.

Table 1* Overall assessment including the Australian airports regime

Criterion/Regime	Ex ante	Thresholds	Competition policy	Australian airports
Preventing excessive pricing	√√√	√	xxx	√
Efficient & timely investment & innovation	√	x	√√	√
Operating efficiency	√√	√	√	√√
Regulatory burden	x	x	√	√
Predictability & stability of regulatory process	√√	x	√	√
Overall net score	7	-1	2	6

On this basis, an information and disclosure regime as applied in the Australian airport sector is as good as a thresholds regime in terms of preventing excessive pricing, and better than it on all other criteria. It is better than a competition policy regime in terms of preventing excessive pricing, roughly comparable to it in terms of the two efficiency criteria, and equal to it in terms of regulatory burden and process. It is worse than ex ante price control on two criteria, the same on two, and better on one.

As a crude measure of aggregation, suppose we award one point for each tick and deduct one point for each cross. Then a thresholds regime gets an overall net score of

minus 1, a competition policy regime gets plus 2, an information and disclosure regime gets plus 6 and ex ante price control gets 7. A close run race, on what we estimate would be LECG's own judgements.

4. Ex ante price control and excessive pricing

Not surprisingly, some of the judgements in LECG's Table 1 might be debateable. For example, it is not clear why a competition policy regime does not score as highly as ex ante regulation in terms of operating efficiency. And three crosses might be rather harsh on competition policy, given the view of the CAA and Ofcom that, at certain regulated airports and for certain regulated telecommunications services, a competition policy would protect customers against excessive pricing just as well as price control would.

The evaluation of ex ante price control in terms of preventing excessive pricing deserves a little more consideration. The assessment framework explains that the first criterion is "The restraint of market power. That is, to protect consumers by aligning prices with costs." (paras 3.25, 3.26 and Table 2) LECG1 gives ex ante regulation three ticks here, the best mark of any regime on any criterion. This is on the basis that "The available evidence shows that ex ante price controls have led to significant real reductions in price across regulated sectors". (paras 1.18 and 6.10) LECG1 concludes that "It is clear that ex ante regulation can effectively protect consumers from excessive pricing." (para 1.18) It then proposes that "To move away from ex ante regulation would therefore require strong evidence of countervailing benefits to match the dis-benefit to consumers of high prices." (para 1.22)

Are such strong words entirely defensible? While it may be clear that ex ante price control "can" effectively protect consumers against excessive pricing, it is also clear that it does not always do so. For example:

- There is evidence that electricity distribution prices in NSW, Australia, have increased significantly faster than in GB, though both are regulated ex ante.[5]
- The initial ex ante price controls on all the GB privatised companies (admittedly set by government not by regulators) led to such consumer and public concern that the next government imposed a windfall profits tax.
- Despite significant subsequent price reductions in GB, there has been no shortage of critics arguing that 'prices should have fallen further' and that 'profits are still excessive'. Even Ofgem, in the only reference on this issue cited by LECG, is left wondering whether all customers have been adequately protected.[6]
- In Florida, large users and the Public Counsel (on behalf of all consumers) became so concerned at the Public Services Commission agreeing with the

[5] Bruce Mountain and Stephen Littlechild, "Comparing electricity distribution network costs and revenues in NSW and GB", forthcoming.

[6] "8.3. We have also found evidence that the regulated networks have generally managed to beat the regulatory settlement. Whilst this in itself is not necessarily cause for concern, there are questions about the extent to which companies are able to outperform and whether those companies earning the highest returns are indeed those that perform best for consumers." Ofgem, "Regulating energy networks for the future: performance of the energy networks under RPI-X" http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/Performance%20of%20the%20Energy%20Networks%20under%20RPI-X%20FINAL_FINAL.pdf , February 2009 [ref 13c/09], cited in LECG1 para 6.10 fn 80.

> utilities to use excess earnings to write down regulatory assets that they were prompted to negotiate with the utilities for immediate price reductions for consumers. In effect, it was the failure of ex ante regulation to 'protect consumers against excessive pricing' that led to the emergence of negotiated settlements in Florida, as a preferred alternative to ex ante regulation.

In various developed as well as developing countries, ex ante regulation has sometimes been used to hold prices below cost. This is inconsistent with aligning prices with cost, and protects consumers only in a short-term sense. It may well be associated with lower network investment and lower quality of service, or more erratic and uncertain pricing, which hardly protects consumers.

LECG's own analysis of consumer appeal rights indicates that ex ante regulation as presently practised in the GB energy sector may have limitations with respect to protecting customers. For example, "The current set of appeal rights could mean that at the margin there might sometimes be too little weight given to the interests of consumers and users in making decisions." (LECG2 para 1.6) Introducing consumer appeal rights "will lead to a more appropriate 'balance of power' during price control processes", and have the "potential to improve the outcome of price control determination, which could have significant benefits for consumers". (LECG2, para 1.3 Table 1) "A relatively small change to key parameters, such as the cost of capital or incentive arrangements, can result in a difference of several hundred million pounds worth of charges borne by consumers." (LECG2 para 1.7)

None of this is to denigrate the substantial achievements of GB regulators in using RPI-X regulation to protect consumers. But ex ante regulation is not necessarily infallible in protecting consumers, and consumers have sometimes expressed their own reservations about its implementation. And other regimes, as CEPA has argued, may be able to combine ex ante and ex post components so as to get the best of both worlds. To assume that any move away from ex ante regulation would necessarily mean higher prices may therefore not be conducive to fairly appraising the alternatives.

Perhaps two ticks for ex ante regulation rather than three would have been a more realistic appraisal on this criterion? Which would then put ex ante regulation and ex post (information disclosure) regulation on level pegging ….

5. The nature of Australian airport regulation

LECG1 variously describes Australian airport regulation as 'light-handed regulation', 'information disclosure' and 'a monitor, review and sanction approach'. (paras 5.106, 109, 107) These are valid descriptions, but they do not tell the whole story. The policy is more than information disclosure, monitoring and the threat of re-regulation, in four main respects. The Annex to this paper sets out a fuller account of the policy and experience than was possible in LECG1. Here we note a few main points.

First, a key element in the policy is what LECG1 refers to as the 'obligation to negotiate'. This is shown in its Figure 1 spectrum. It is reflected in the comment that the regulated firm 'must undertake good faith negotiations with its customers according

to a prescribed process'. (para 1.6) But LECG1 makes no further reference to this concept.

As explained in the Annex, both the PC and successive Australian governments have regarded the encouragement of commercial negotiations between each regulated (airport) company and its (airline) customers as being at the heart of the light-handed regime.[7] It was such negotiation that would lead to the needed investment. [8] It is now explicitly established as a basic Principle for setting prices, quality and other terms.[9] And it was the concern to protect the principle of commercial negotiations, and to avoid undermining it, that led the PC to argue against the intrusion of a too-easily available Part IIIA access regime and independent dispute resolution, and to propose instead a more explicit 'show cause' early-warning procedure in the event of concern.

Second, an important factor is the historical experience during the previous five year price cap period: the price caps themselves and the building-block approach taken by the ACCC in assessing the case for, and allowable return on, new investment. On the one hand this was a confrontational process that neither airports nor airlines wish to see repeated, and this has encouraged them to make the present light-handed regime work. But at the same time it also provided them with a publicly available template according to which they could assess a reasonable return on existing and new investment going forward into the light-handed regime, and thereby reach agreement.

A third element is the ex ante guidance embodied in the Aeronautical Pricing Principles. These Principles were first outlined in 2002 then updated to address the outstanding issues in 2006/7 (notably asset revaluation). They could if necessary be further updated in future. This provides the ability for the regulatory regime to respond to new issues not covered in the earlier ACCC decisions.

A fourth key element is the additional impetus to commercial negotiations provided by the Part IIIA determination that the airlines could if necessary seek independent arbitration in order to get acceptable terms of access. Admittedly it was costly and time-consuming to acquire that legal right, and it might in future be removed. However, it had an immediate and positive impact in terms of enabling the parties to reach agreement.

To summarise, in Australia there is a coherent and comprehensive regulatory philosophy and framework in place that goes far beyond 'let's see what happens and if we don't like it we'll re-regulate'. The provisions for information disclosure, monitoring and the threat of re-regulation lie within an obligation to negotiate commercially in good faith and with transparent information exchange. Conduct is informed by a mixture of previous experience, ex ante guidance with provision for

[7] To take just one of many statements, "Perhaps most importantly, as compared with more intrusive regulation, price monitoring can facilitate commercial negotiations between airport operators and users" (PC 2002 p. xxxiii)

[8] E.g. "The ongoing need for substantial investments at major airports requires a more commercial and cooperative approach." (PC 2002, p. xlv)

[9] "prices (including service level specifications and any associated terms and conditions of access to aeronautical services) should: (i) be established through commercial negotiations undertaken in good faith, with open and transparent information exchange between the airports and their customers and utilising processes for resolving disputes in a commercial manner (for example, independent commercial mediation/binding arbitration)".

updating, a statutory right to arbitration and a potential show-cause early warning system.

6. Re-appraising ex post regulation Australian style

LECG instanced Australian airport regulation as an example of ex post regulation. We conjectured that LECG's own evaluation of this regime would give it a net score of 6, comparable to ex ante price control with a score of 7 (or 6 if the latter is marked less ambitiously on customer protection). We now reappraise the Australian policy in the light of the more detailed account of it given above and in the Annex.

Preventing excessive pricing: LECG1 comments "some restraint but it is likely that prices are above cost". On the face of it, that might make the Australian regime comparable to the thresholds regime that was awarded one tick. However, there is reason to believe it would be better than that. Whereas a thresholds regime sets a pre-determined level that "is unlikely to be as close to cost as an ex ante price control" (para 1.19) the combination of the Pricing Principles and previous experience meant that prices have been set on the ex ante basis that the regulator itself previously determined. The revision to the Pricing Principles has also addressed the concern about the valuation of airport assets leading to controversial price increases, and further revisions to the Principles could address further developments as needed. On this basis, Australian policy deserves two ticks rather than one.

Efficient and timely investment and innovation: LECG1's comments previously suggested one tick (conservatively). However, we should give weight to the strong view of the PC that the regime would be and has been better for investment than an ex ante price control regime, and the evidence that airports and airlines have basically been able to agree on future investment plans. In this respect, airports are providing what their customers want, and it is difficult to ask for more. There is a separate issue, as to whether providing what customers want is a good thing in the energy sector.[10] On this basis LECG1 holds that innovation and investment to meet consumer demand is less attractive than innovation to meet climate change. (para1.46) Nonetheless, a competition policy regime gets two ticks on this criterion and it would seem that Australian policy deserves a comparable mark.

Operating efficiency: we conjectured that LECG1 would have awarded two ticks here. The more detailed analysis gives no reason to doubt that. All parties have been concerned to improve airport efficiency, and this has happened.

Regulatory burden: We conjectured that LECG1 would award one tick here, comparable to a competition policy regime. However, the score for the competition policy regime itself seems unduly low. Perhaps this reflects the pessimistic appraisal in the concluding section.[11] But against the hypothetical "considerable number of

[10] "While unregulated markets may be good at delivering what consumers want, a key requirement of energy markets is to promote sustainability and the interests of future consumers, and this may differ from meeting the desires of current consumers." (para 1.30)

[11] "An ex post competition policy regime would avoid the cost of setting price controls or thresholds, but it still may lead to a considerable number of complaints. A competition breach would entail lengthy investigation by the relevant competition authority or regulator with concurrent powers. The development of 'private enforcement' could also lead to extensive litigation." (para 1.38)

complaints" and "lengthy investigation" and "extensive litigation", contrast LECG1's appraisal of the actual US case study, which says nothing about such outcomes and/or comments favourably on their absence.[12] If three ticks is the maximum score on any criterion, it would seem that a competition policy regime is a candidate for three ticks on regulatory burden, or at least two, rather than one.

Similarly, one tick seems a pessimistic score for the Australian airport regulation regime. The routine information disclosure, monitoring and reporting is not burdensome, and (as intended) is helpful to both parties as well as the government. The regime has not been characterised by "a considerable number of complaints", not least since airports seem to have set prices consistent with the stated Principles. There has not been a competition breach: the regime is set up to make clear ex ante what each party's obligations are, with a view to avoiding such breaches. LECG1 makes reference to "some scope for arbitration", which may be interpreted as a negative aspect but others would see it as positive. If the Part IIIA saga is regarded as 'private enforcement', this did indeed involve extensive litigation. Arguably, however, that was a one-off decision process that established precedent. Having established the right to arbitration the parties were subsequently able to settle without the need for further litigation. The airlines emphasise their wish to avoid such litigation in future, and their belief that the possibility of arbitration will help to enable this.

It is true, as John France points out, that parties will need to come to terms with the kinds of issues covered in previous price control reviews. In this respect, GB regulation is more complex than in Australia or elsewhere. But LECG1 argues that these may be considered "significant 'set up costs' that are now effectively sunk". (para 1.36) Moreover, subject to meeting any requirements laid down by Ofgem or the Government, the way in which the parties deal with these complexities will be within the control of the parties themselves.

For these reasons, Australian regulation seems to merit two ticks against regulatory burden, rather than one.

Regulatory certainty and transparency: LECG1's references to 'regulatory threat' and 'airlines concerned by the process' implied that LECG1 would have given one tick here, comparable with a competition policy regime and less satisfactory than an ex ante regime. However, this seems unduly harsh. LECG1 explains that "Regulatory threat is dependent on monitoring and regular review by the PC. Process appears to be workable". That is surely an understatement: the process has worked rather well and is not perceived as a 'regulatory threat'.

LECG1 qualifies its approval by saying "though airlines clearly concerned by the process". When asked, some airlines not surprisingly expressed some concerns, as do customers of regulated industries throughout the world. But their concerns are relatively specific: some would like different definitions of quality of service and associated incentives, and they would like access to independent dispute resolution. These are not benefits that airlines enjoyed under the previous ex ante regime; the present arrangements are better than they were under ex ante regulation; in most

[12] "The US regulatory process was subject to considerable litigation at both a Federal and state level, which resulted in significant costs. Regulatory process costs were also high. These costs have been avoided under the move to ex post competition." (para 5.101)

respects airlines seem to have reached an acceptable outcome with airports; and relationships continue to improve over time. The airlines see scope for further improvement but they are not calling for a fundamental change in the regime, certainly not back to the previous ex ante regime. Their views, while important to consider, do not compromise the regulatory stability of the regime.

LECG1's criterion (the wording of which varies through the Report) defines 'stable and predictable regulatory process' as "provides certainty to stakeholders and can be understood by market participants and investors". (para 3.26 Table 2) It would be difficult to fault the Australian regime on either of these scores. Admittedly it has been in effect for only seven years or so (or a dozen years if the initial price cap period is included). But it has been eminently stable to date, generally regarded as successful, broadly supported by the market participants, has been able to adapt in the light of experience, and importantly has been endorsed by two successive governments. There is no talk of abandoning or significantly modifying it.

LECG1 identifies comparable virtues with the present ex ante regime in the UK, which seems fair. But as regards regulatory certainty and stability, however, it might be noted that Ofgem's own RPI-X@20 Review is exploring the case for possibly significant changes to that regime; that the present Government has recently proposed a new Energy Bill to require Ofgem to include the reduction of carbon emissions and the delivery of secure energy supplies in its assessment of the interests of customers, and has suggested the need for a more 'muscular' approach to the industry and to forward planning; and that the Conservative party too seems to envisage significant changes to the energy sector. All of these factors could presumably impact on regulatory stability of the ex ante regime in the UK. In sum, if ex ante regulation UK style retains two ticks for regulatory stability, then ex post regulation Australian airport style would seem to merit two as well.

Inserting these revised values from the last two sections into LECG1's Table 1 yields the overall assessment in Table 1**. A competition policy approach now looks a little better than before. However, the main outcome is that ex post regulation Australian airport style now scores comfortably ahead of ex ante regulation.

Table 1** Overall assessment - Revised

Criterion/Regime	Ex ante	Thresholds	Competition policy	Australian airports
Preventing excessive pricing	√√(√)	√	xxx	√√
Efficient & timely investment & innovation	√	x	√√	√√
Operating efficiency	√√	√	√√	√√
Regulatory burden	x	x	√√	√√
Predictability & stability of regulatory process	√√	x	√	√√
Overall net score	6-7	-1	4	10

7. Other considerations

LECG1 assesses the various regulatory regimes against the above five criteria. These criteria cover a number of important aspects, but are they complete? Arguably, some are a bit narrow. For example, protecting customers is defined in terms of relating prices to cost. There is no reference there to the quality of the service provided, or indeed to the definition of the service provided. Is it the service that customers most want? Thus, there is little evaluation of alternative regimes in terms of the ability to discover and provide what customers want.

To the extent that it is discussed, LECG1 suggests that this aspect is relatively unimportant in the energy sector compared to the telecoms sector, because of climate change. But is that really true? Will it not be relevant to discover what kinds of energy efficiency measures are preferred by customers and how best to offer and deliver them? And what kinds of terms and conditions are most helpful for renewables and distributed energy providers? Even if there are government targets to be met, will it not be helpful to discover the most effective ways to meet them, which surely depends on consumers and suppliers as well as networks?

The criteria also make no reference to the extent and exchange of information within a market, to the nature of relationships between the parties within that market, and to how this might be impacted by the form of regulation. An unintended consequence of ex ante regulation, not least RPI-X regulation as applied in the UK but also in Australia, has been a tendency to polarise and politicise the industry. The centralisation of decision-making within the regulatory body has encouraged companies and customers to address their views and complaints and response to the regulator – and indeed to politicians and government - rather than to each other. This in turn focuses more questioning on whether the regulatory body is discharging its duties adequately.

Experience with greater customer involvement in other jurisdictions, including ex post regulation as applied in the Australian airport sector, is that companies and customers get to know more about each others' preferences and abilities to provide services. Moreover, relationships within the industry improve. Instead of spending time and money to knock down the arguments of the other side, efforts are devoted to finding mutually advantageous ways forward. The regulatory body is in the background rather than the foreground.

Improved information flows and company-customer relationships have been observed in those sectors of the UK where such approaches have been tried, notably constructive engagement in the airline sector and the use of the Quadripartite Working Groups in the water sector.[13] Ofgem has also referred positively to analogous developments in other parts of the energy sector. It is perhaps not surprising that it is in those sectors where centralised decision-making is at its greatest, namely the network price controls, that the call arises most strongly for greater appeal rights for consumers against the decisions of the regulators.

8. The arguments on customer appeal rights

In brief, the contributors to this debate argue as follows:

[13] Cf Stephen Littlechild, "Constructive engagement and negotiated settlements - a prospect in the England and Wales water sector?", 29 August 2008.

LECG2 argues that introducing a right of consumer appeal would improve the regulatory process (in terms of regulatory accountability, greater involvement of customers in the process, and improved balance of power as between companies and customers), bring benefits to customers and give more appropriate weight to sustainability considerations. It would also be complementary to increased consumer engagement. Direct costs would be relatively small and indirect costs (uncertainty) could be minimised.

The appeal should be to the CC, which would also act as the 'gatekeeper' (deciding which appeals it should hear). It should review and re-determine the whole of the price control decision rather than particular parts.

John France argues that giving appeal rights to some interested parties (eg consumers) will increase their influence at the expense of parties who do not have such rights (eg environmental groups). It is harder (but not impossible) to give rights to the latter, hence environmental considerations would be likely to feature less strongly.

References to the CC would be more likely because it is harder to reach agreement among many people than between two. Ofgem would become more of a mediator between the parties with appeal rights, and Ofgem's review would be a preliminary skirmish before the real action at the CC.

The process could tend to a negotiated settlements approach. This could work though the benefits would not be as great as in the US where the litigated approach is less satisfactory than the RPI-X control process in the UK.[14]

CEPA argues that greater involvement with customers would be desirable, that the present process has pushed the process too far in favour of regulated companies, that the lack of references to the CC is undesirable, and that in future there is a risk of the role of customers being down-played. Approaches that use greater customer involvement will not necessarily lead to a culture change if only the regulated company can reject the regulator's proposals. Consumer appeal rights would involve customers earlier and more deeply, improve the regulatory process and help inform future decision-making.

[14] John France also suggests exploring pendulum, which has been provided for in network regulation in Guatemala. (It is sometimes called Final Offer Arbitration or 'baseball' arbitration, after its use in that sport in the US.) We do not explore this further here since a) he instances its operation as between company and regulator, which does not directly address the customer appeal question, b) no evidence of its actual operation is given, c) CEPA notes some potential problems with that approach, including not encouraging dialogue between the parties and the difficulty of choosing between two unattractive alternatives, and d) my understanding is that pendulum arbitration is not straightforward in practice and is still prone to gaming (eg with respect to the definition and multiplicity of the options put forward). A recent quite extensive survey of one area of application is relatively critical. Frank Neuhauser and Charles Lawrence Swezey, *Preliminary Evidence on the Implementation of 'Baseball Arbitration' in Workers' Compensation*, Report prepared for the Commission on Health and Safety and Workers Compensation, State of California, December 1999, available at http://www.dir.ca.gov/chswc/BasebalArbFfinal.htm. For a claimed better approach, see Cary Deck, Amy Farmer and Dao-Zhi Zeng, "Amended Final Offer Arbitration outperforms Final Offer Arbitration", *American Law and Economics Review*, advance access published online October 19, 2007.

The appeal process will not be abused because frivolous appeals will be discouraged, including by the time and costs involved. As a result, Ofgem's role will not be weakened. Companies will engage more actively with customers, and will benefit from a more stable regulatory regime as a result of decisions being more soundly based.

9. Discussion of the arguments on customer appeal rights

There seems to be broad agreement that establishing customer appeal rights would impact on the regulatory process: customer representatives would be more actively involved and the outcomes would more closely reflect their interests. Presumably, most people would regard this as a desirable outcome, other things being equal. What then might be reasons for arguing against it?

John France argues that the interests of those without appeal rights would be adversely impacted, notably the environmental groups and the implications for sustainability. I have argued elsewhere that the regulatory process in the UK water sector shows that it is possible and desirable to include environmental considerations at the heart of a process of customer involvement.[15]

John France further points out that that customer representatives will need to be informed and resourced in order to participate in negotiated settlements or constructive engagement. This is true, and equally the case for ex post regulation Australian airport regulation. It would also seem to be true for instituting consumer appeal rights. In fact, there would be an inconsistency in postulating a consumer body able and willing to make informed judgements and representations as to the (in)adequacy of the regulator's proposals, and to take forward an appeal process on behalf of consumers, while at the same time claiming that consumer representatives are unable and/or unwilling to play an adequate part in representing the interests of customers in negotiations with companies as an alternative to the conventional regulatory process. That is, ability to represent customer interests adequately is all of a piece, whether before or after a regulatory decision.

There is a concern that the process would be sidetracked or made unduly expensive by excessive appeals. CEPA suggests a 'gatekeeper' to assess appeals and allow only the serious ones. It would be straightforward to weed out appeals from individual citizens who simply said 'the proposed price is too high', and gave no further basis for overturning the regulatory proposal.

But any body with a serious interest in the issue would have no difficulty in producing a coherent consultant's report making a serious case. It might argue, for example, that there was evidence of greater productivity improvements in some allegedly comparable industry and that a reasonable cost of capital would be a few basis points lower, and therefore that prices ought to be lower than the regulator proposes. The regulator will presumably have considered and rejected this argument, so clearly cannot be the

[15] Littlechild and Cornwall, op cit., and Stephen Littlechild, "Constructive engagement and negotiated settlements - a prospect in the England and Wales water sector?", 29 August 2008. Experience with the Quadripartite Working Groups in the UK water sector is particularly relevant.

gatekeeper. But for the CC to assess and pronounce on it as gatekeeper is tantamount to hearing the appeal.[16] So the gatekeeper idea is of limited assurance here.

What then would prevent customer representatives (or others) from appealing almost every regulatory decision? First, as CEPA has explained, to bring an appeal and participate actively in it so as to provide maximum chance of success is a costly and time-consuming activity with uncertain outcome and possible loss of reputation. It is not to be undertaken lightly. This undoubtedly weighs with regulated companies at the moment, and helps to explain why their appeals to the CC have been so infrequent. These considerations could be expected to weigh equally with large users who have to pay both the prices at issue and the costs of an appeal. A consumer body financed by such users would also be responsive to such considerations. More questionable, perhaps, would be public consumer bodies that might deem it sufficient to set an appeal in motion with little aim to argue the case, and regardless of the prospects of success or of the outcome. But some consumer bodies have shown responsibility on this score (notably the Electricity Consumer Committees set up at the time of electricity privatisation, and nowadays the Consumer Council for Water).

The other factor mitigating against frequent appeal is the possibility of securing a more satisfactory and more certain outcome without going to appeal – that is, by negotiation. As explained above, where negotiated settlements (and constructive engagement) are possible, they frequently happen: the parties prefer to agree than to go to appeal. CEPA suggests that, in effect, the same thing happens in UK regulation at the moment, except that it is the regulator and the regulated company that effectively negotiate an agreement.

The extent to which this second factor is influential will therefore depend on the scope for the parties – company and users/consumers – to negotiate and come to agreement rather than run the risk of appeal.

At present, this scope is perhaps negligible with respect to GB energy network price controls (as opposed to in the UK airport sector) – at least, it is not encouraged or even acknowledged. John France argues plausibly that a consequence of allowing consumer appeals is that this would change: companies would recognise the need to get the agreement of consumer representatives in order to secure an acceptable deal and avoid the CC, and would therefore engage in negotiations with them.

John France argues further that Ofgem would in effect be marginalised: it would become more of a mediator between the parties with appeal rights, and its review would be a preliminary skirmish before the real action at the CC. CEPA argues that the right to appeal will not be abused because frivolous appeals will be discouraged, and appeals can be limited in other ways, hence Ofgem's role will not be weakened. This does not really address John France's argument that the very existence of consumer appeal will lead parties to sideline Ofgem. Indeed, ironically, the more that Ofgem insists on its traditional role, and resists the role of mediator, the more likely it is that the parties will sideline Ofgem and go to appeal if they are unable to reach agreement.

[16] There would be ways in which an informed organisation could evaluate the strength and nature of objections, for example in the way that FERC deals with contested settlements (see Wang add reference), but they would still need considerable familiarity and involvement on the part of the CC.

But is this an argument against a right of consumer appeal? Elsewhere, regulators have actively chosen to act as mediator with a view to facilitating negotiated settlements (or constructive agreement), on the basis that these are in the mutual interest of companies and customers. They can serve this purpose better than the regulator can. The regulator's most appropriate role is to facilitate, and where necessary to act as backstop.

10. The arguments against consumer appeal

If the above arguments provide no strong case for arguing against consumer appeal, what then is the case for not implementing it? I suggest that the case for consumer appeal implies a different approach to regulation, and that considerations of practicality argue against creating an explicit right of consumer appeal in the immediate future.

The traditional ex ante approach to regulation – what CEPA describes as effectively negotiating bilaterally with the companies and taking a 'consult and explain' approach to consumers – presumes that parties other than the company are unable effectively to represent their own interests, so the regulator alone must decide the content of the price control proposal. Companies who can represent their own interests have the right to appeal in the event that their 'negotiations' with the regulator fail to reach agreement, but the interests of consumers and users are best represented by the regulator.

The argument for allowing consumer appeal presumes that the above propositions are no longer self-evident valid. Regulation necessarily has limitations, the regulator cannot be relied upon to act in the best interests of consumers and users, and consumers and users know enough to challenge the regulator on this issue. Consumers and users can represent their own interests, and are therefore effectively in 'negotiation' with the regulator. But they are disadvantaged because, if they fail to reach agreement, there is no means of adjudication of this 'dispute'.

However, if it is accepted that consumers and users are indeed able effectively to represent their own interests –at least, enough to challenge the regulator - this has implications for the nature of regulation as well as for the nature of consumer appeal. It implies that the regulator could and should enable consumers and users (or their representatives) to negotiate directly with the companies. That is, regulation can facilitate negotiated settlements or constructive engagement, or adopt an ex post approach in the spirit of Australian airport regulation. In those approaches, consumer representatives are engaged from the beginning and throughout the process – their participation is of the essence of the process. What is then needed is arbitration by a neutral party if the company and customers are unable to reach agreement. This does not need to be provided by the CC: it could be provided by the regulator.

In this context, the arguments for not providing a right of consumer appeal to the CC are perhaps twofold. The first is that it seems inefficient immediately to escalate to the CC each and every issue on which customers and companies are able to agree. The first stage might perhaps be independent dispute resolution from a professional arbitrator selected by the parties. If this is not appropriate, then appeal to the sector regulator would be the next step. That regulator is likely to be better informed and better prepared to deal with 'everyday' issues than the CC. The sector regulator would be better able, amongst other things, to assess the nature and substance of any consumer

complaints against the company's arguments, or against agreements reached by some but not all of the participants in the process.

This then allows, if necessary, the possibility of further appeal to the CC. At present, only the company can appeal in this way. CEPA argues that this may not be sufficient. "While ex ante approaches [to greater involvement of consumers] are helpful, they do not necessarily lead to a culture change, given that the regulator still knows that it is only the regulated company that can reject its approach." (p 4) However, while they may not "necessarily" lead to a culture change, in practice they may well do so. The greater involvement of consumer groups at the earlier stage may go far to change conduct, and to address concerns about lack of consumer appeal rights under the present approach.

The second argument for not providing for consumer appeal to the CC is that it would require a change in legislation, while providing for consumer appeal to the regulator does not. A change in legislation would require considerable preparatory work, would necessitate taking a view on all the details that the papers have noted - such as who is to be allowed to appeal, to whom and on what basis, within what timeframe, and so on. The timing and outcome of any new legislation would be uncertain. And the CC might need to gear up specially in case there were a flow of new references.

11. Conclusion

The argument for not extending the right of consumer appeal to the CC is thus a pragmatic one, rather than one of principle. Maybe, in future, it will be considered desirable to provide such a right, just as the company now has a right. But significant progress can be made today in addressing the concerns of customers, short of such a drastic step. Within present legislation, that progress lies within the gift of the sector regulators. They can move towards ex post regulation Australian airport style – or, closer to home, can accept, with the CAA, that under conditions to be defined and facilitated by the regulator, and with important regulatory protections, consumer and user representatives can represent their own interests in negotiations with the companies. On that basis, sectoral regulators will naturally provide a de facto right of consumer appeal.

ANNEX Summary of four relevant papers

12. LECG on ex post regulation

LECG1 suggests that different forms of ex ante and ex post regulation lie on a spectrum. (paras 1.3-1.6) It illustrates with the following policies:

- ex ante price control regulation as in the UK, possibly with ex post adjustments in response to factors outside management control
- ex post price reviews with ex ante specification of a costing approach, as applied in Sweden and Finland
- a non-binding threshold regime, with violations subject to investigation, as applied in New Zealand
- information disclosure and an obligation to negotiate, as applied in Australian airport regulation
- competition policy, as applied in US telecoms fibre access.

Its review of the economic literature concludes 1) that there is strong support for ex ante regulation where there is market power, to protect consumers from excessive pricing; 2) that in practice it may be difficult to design an ex post regime to provide the same level of consumer protection as ex ante regulation; and 3) certain ex post regimes can provide better incentives to innovate. (paras 1.7-1.9 and 4.25)

In practice, ex ante regulation is typically applied where there is significant market power. Moves from ex ante to ex post control have been associated with the development of competition. Where there is continuing market power, countries that adopted ex post regimes have typically done so after no-regulation, and have progressively refined the regime with ex ante features, thereby moving towards ex ante control. But the regulation of airports in Australia is a notable exception to this. (paras 1.10 – 1.13)

LECG1 appraises ex ante and ex post regulation against the following criteria:

- protect consumers (preventing excessive pricing)
- operational efficiency
- efficient and timely investment and innovation
- regulatory burden
- predictability and stability of regulatory process.

The paper reviews experience with the costing approach in Sweden and Finland, and with information disclosure in Australia. However, these are not evaluated in detail. "We believe that the main insights can be obtained by focusing on the threshold and competition policy approaches". (para 1.15)

LECG1 ranks thresholds the same as ex ante regulation with respect to regulatory burden, and worse on the other four criteria. It ranks competition policy slightly better than ex ante regulation on two criteria (investment and innovation, and regulatory burden), slightly worse on two other criteria (operating efficiency and regulatory process), and very significantly worse on protecting consumers by preventing excessive pricing. (Table 1)

On this basis, LECG1 concludes that there do not appear to be significant benefits to consumers from moving from an ex ante form of control to an ex post form of control. The relative strengths of competition policy are less significant in the energy sector than in telecommunications:

- As regards innovation, "it is not consumer demand that drives the fundamental changes required of the sector, but the need to address climate change", and "the low price elasticity and uniform nature of networks is likely to diminish the opportunity and incentive to innovate under ex post regulation".
- As regards burden, "we are not convinced that a move to ex post regulation would lead to a lower level of regulatory burden" because Britain "has already invested significantly in 'sunk costs' in setting up the regime" [of methodology and reporting]. (paras 1.43-1.45 and 1.39)

For both electricity and gas networks, "the need to prevent excessive pricing remains a key factor". (para 1.46) "Innovation and investment are extremely important to the future of electricity networks … but in practice ex regulation may provide little or no real gain in terms of innovation." "For gas networks, with less apparent need for investment and innovation … ex post regulation is more attractive. However, the problems with ex post regulation do not outweigh the potential benefits [sic – should this be the other way around?]" (para 7.36)

The recommended solution (if one is needed) is a possible modification to ex ante regulation, albeit at a cost.

- In electricity, "It should be possible to design ex ante regulation to provide some incentive for innovation, although this may require a trade-off with short-term benefits from lower prices". (par 1.46)
- In gas, "if it becomes clear that gas use is declining and there are relatively few complex regulatory issues, then Ofgem could consider simplifying the current price control approach. In doing so, however, it would need to bear in mind the potential trade off relating to loss of consumer benefits under the present regime." (para 1.47)

13. LECG on consumers' and users' right to appeal

LECG2 investigates the advantages and disadvantages of introducing a right of appeal, on the substance of the regulatory settlement, for consumers and/or network users. Where potential disadvantages are identified, it also investigates possible measures to mitigate those disadvantages. Finally, it addresses a range of more detailed implementation questions. (para 1.1)

No explicit criteria are identified (e.g those used in evaluating ex post pricing). The summary of advantages and disadvantages of appeal rights is as follows (Table 1): Positive attributes are:

- good regulatory process (promote accountability of Ofgem to consumers and users, provide stronger incentives for them to engage in the price control process and for networks to engage with them, and lead to a more appropriate 'balance of power' during the price control process)
- consumer benefits (potential to improve the outcome of price control determination for consumers), and

- sustainability (help ensure that these considerations are given appropriate weight in price control decisions).

Negative attributes are:

- direct costs (for appellants, networks and Ofgem from increased number of appeals) and
- indirect costs (increased uncertainty for networks).

LECG2 estimates that the direct costs would be relatively small (an order of magnitude less than the benefits to consumers from an improvement in decision-making). The appeal body acting as gatekeeper to the appeal process would prevent frivolous appeals and unnecessary costs. The indirect costs could be more significant, but in practice would be modest if the appeal is conducted in a reasonably short time period (eg six to nine months).

On the design and implementation of appeal rights, LECG2 suggests that

- the Competition Commission (CC) should hear appeals
- materially affected parties (most likely users and consumer representatives) should have appeal rights
- the legal test should be whether Ofgem's proposed price control is adverse to the public interest
- the CC should generally review the price control decision as a whole and not just matters raised by the parties
- measures to discourage frivolous appeals and reduce uncertainty should include a 30 day deadline for appeal, a 4-6 month period for CC to hear and decide, CC (as gatekeeper) to grant permission before an appeal can be lodged, and CC to allocate costs of successful party to unsuccessful party (with discretion)
- if an appeal is sustained, the CC should as far as possible re-determine the price control decision.

LECG2 recommends that appeal rights be extended to consumers and users in this way. It comments that "extending appeal rights would be complementary to increased consumer engagement. (para 1.36)

14. John France on consumers, stakeholders and appeal mechanisms

John France's argument may be summarised as follows. The present (ex ante) regime was well considered:

- RPI-X regulation is founded on the principle that the firm will look after its own interests and that other interests must be weighed and balanced by the regulator guided by its statutory duties
- The public interest is not the same thing as the interests of consumers, though they are pre-eminent
- The privatisation regimes gave a direct power of veto to the person whose property rights were being constrained by the licence, and other interests were protected by other aspects of the regime.

Giving rights of appeal to others is problematic:

- Giving rights of appeal or veto to some stakeholders (consumer and user groups) but not others (eg environmental groups) will reduce the influence of the latter

- It is hard to give status to environmental stakeholders in appeal mechanisms.
- So giving rights of appeal or veto to consumers or users (suppliers) will make it less likely that environmental considerations will feature strongly in price control reviews.

Allowing suppliers as users to negotiate on behalf of consumers is not the solution:

- The interests of suppliers (as users of the networks) are not aligned with those of consumers, though they may sometimes coincide
- Suppliers are commercially indifferent to the experience of end-users with respect to network services
- There is no case for conferring rights of appeal or veto on suppliers.

References to the Competition Commission would be much more likely:

- This is not least because it is harder to reach agreement among many people than between two.
- The greater the number and the greater their diversity, the more pronounced this tendency will be.

Appeal rights would change Ofgem's role significantly:

- The regulator would have to satisfy not only the licensee but also all other parties to whom the right had been granted
- Ofgem would become more of a mediator than a regulatory decision-maker
- Ofgem "would have more of an honest-broker role between the parties that had rights of veto or appeal. Its review would be exploratory and rapidly confined to facilitating multilateral discussions between the parties." (para 84)
- "Everyone would know that Ofgem's review was merely a preliminary skirmish, or an exploration of the points at issue, before the inevitable review took place at the CC." (para 85)

The benefits of such a process might be limited:

- It would be possible to work towards improving the information that the regulator uses at a price control review. This needs little change to present arrangements and resources.
- If consumer representatives were given real power to negotiate agreements with network operators, they could not avoid considering the complex issues that currently arise in price control reviews. So they would need expertise and resources.
- It is not impossible to introduce a wider stakeholder group to a negotiated settlement process. Over time the resulting process would begin to establish the weight to be given to the various interests, and being to influence negotiations between companies and customer representatives.
- But would it improve things?
- In the US, the alternative to the negotiated settlement is the regulatory litigation process. In the UK the alternative is the present RPI-X price control review process. Insofar as the latter is superior to the US litigation process, the benefits of negotiated settlement in the UK may be less than in the US.

There is an alternative form of consumer empowerment:

- Pendulum arbitration has been used in setting network access prices in Guatemala and recommended for use in Chile.

- The defined parties to the negotiation are given a maximum period to negotiate an acceptable settlement. If they are unable to agree, an arbitrator chooses between the two final offers presented by the parties to the dispute. The arbitrator may not propose or determine anything else.
- "It is said that such a regime limits the parties' posturing incentives … and that it is in each party's interest to make an offer that is marginally fairer than the opponent's expected offer, giving a strong incentive both to make reasonable offers and to reach a negotiated agreement." (para 129)

This approach is not without its own problems, however:
- It would probably require a change in primary legislation.
- "Moreover, for pendulum arbitration to work effectively, *all* levels of the appeal process must be similarly constrained. Otherwise the posturing incentives are still present." (para 131)
- A number of issues would require further careful consideration. It is not clear how the mechanism deals with a situation where both sets of proposals are deficient, but in different ways. "The RPI-X project might seek to discover how such problems have been overcome in the regimes in which it has been tried." (para 133)

15. CEPA on consumers' appeal rights

CEPA's argument may be summarised as follows. Is closer engagement with consumers needed? Essentially, Yes:
- Ofgem has made many efforts to pay more attention to the needs of customers.
- Nevertheless, Ofgem's current approach to engaging with consumers is to 'Consult and Explain'. There is limited further redress if consumers are dissatisfied.
- The present process leads Ofgem to focus its time and resources on exploring and responding to company submissions.
- "Price controls boil down to a bilateral negotiation between the networks and Ofgem …and … particularly at the end of a review process, focus is increasingly on 'cutting a deal' with the networks." (p. 3)
- "The current regime has pushed the balance too far in favour of the regulated companies and, hence, it has been more than ten years since an appeal has been made to the CC against one of Ofgem's determinations." (p. 20) This situation is undesirable. (p. 6)
- All this has taken place within the context of a fairly clear primary duty to further the interests of customers. If this duty is diluted through establishing multiple duties [as raised in the White Paper] then there is a risk that conflicts between these duties could lead to the role of customers being down-played." (p. 3)

There are many useful options and precedents for greater consumer involvement ex ante, but they may not be sufficient:
- These include constructive engagement as used by the CAA, consumer surveys as used by Ofwat, ongoing engagement with consumers as utilised by Ofcom, and negotiated settlements as practiced in the US.
- "While ex ante approaches for greater consumer involvement are helpful, they do not necessarily lead to a culture change, given that the regulator knows that it

is only the regulated company that can reject its proposals. Therefore, while it is appropriate to consider in more detail ex ante options, we would not necessarily see them as a substitute for ex post options, but rather a complement." (p. 4)

Pendulum arbitration has been proposed as an ex post option, and is part of the approach to regulating Guatemala's telecommunications industry, but is problematic:

- Pendulum arbitration does not facilitate or encourage dialogue between the parties, thus not leading to easier negotiations over time.
- The arbiter is more likely to accept the utility's proposals because failure to invest in infrastructure is considered a more undesirable outcome than consumers paying excessively. This could lead to the utility making no concessions during the negotiation stage. (p. 19)
-

There are precedents for consumer appeal, and support for it elsewhere:

- "Experience with regard to Energy Codes and in the communications sector, as well as the CC's desire to see the right of appeal extended, have built a compelling case for those who are materially impacted by regulatory decisions to have the right to appeal." (p. 30)

What would be the benefits of granting consumer appeal rights?

- changing the existing balance in the price control process … to one where consumers are fundamentally involved in the process from an early date. This would mean closer, earlier and deeper involvement in the regulatory process.
- Improving the robustness of the regulatory process and consequently decisions, and
- Providing opportunities for appeals that would help inform future decision-making. Appeals should be seen as an opportunity for learning, not as a failure of the regulatory regime.

Who should have the right to appeal?

- Either the law could specify parties that could appeal
- Or the appeal body or some other body could determine this
- The CC has provided support for a right of appeal available to those with a material interest, and for a broad definition of customer.

How can frivolous appeals be discouraged?

- "Irish airports experience demonstrates that an unfettered right to appeal may not be appropriate." However, designing appropriate checks and balances … ought to be achievable." (p. 5)
- Establishing a right to appeal, the costs of appeal and potential costs of other parties if unsuccessful, the time commitment and reputation risk are all hurdles to discourage frivolous appeals.
- Adjudicative appeals on specific points can more easily be subject to a relevance check and to recognition of 'winners and losers' and hence to the award of costs.
- Experience with appeals to the CAT against Ofcom's decisions has shown that sensible rules ensure that only serious appeals are submitted.

What will be the effect on Ofgem?

- "It has been argued that the right to appeal would be abused to such an extent that in effect two price control reviews will take place – the first, by Ofgem, would not be taken seriously by any of the stakeholders, with all of the attention focused on the second review by the CC instead. The perception is, therefore, that Ofgem will effectively be reduced to the role of mediator.
- However, so long as there are mechanisms in place to discourage trivial or vexatious appeals, the right to abuse will only be used appropriately and with due consideration." (p. 27)
- Constraints on broader or narrower (adjudicative) appeals could be considered. "However, no matter what type of appeal is sought we do not believe that this weakens Ofgem's role." (p. 28)

What will be the effect on companies?

- Some companies have argued that extending the rights to appeal would increase regulatory uncertainty and should therefore be accompanied by a higher cost of capital.
- This would not be the case if frivolous appeals were prevented.
- Regulatory uncertainty would in fact be reduced if wider rights of appeal were used to arrive at better regulatory determinations.
- The desire to avoid appeals of its determinations should lead Ofgem to engage more actively with consumers and to take on board their views.
- A culture change might be seen among those companies that currently view customers as more of a hindrance to their operations rather than the key stakeholder that they are.
- This in turn should result in better, more robust and ultimately more acceptable determinations for all stakeholders. (p. 5)
- Investors should be able to take heart from this, and from the prospect that Ofgem's determinations would be less likely to require interim adjustments or significant changes from one control period to the next.

Appeals could help frame future regulatory discussion:

- It is reasonable to expect that Ofgem would 'learn from its mistakes' and over time its decisions would be sounder, its consultation more inclusive and, ultimately, the outcomes would be more in line with its statutory duties.
- Ofgem should therefore undertake consultation into how a wider appeals mechanism might be implemented as well as strengthening the ex ante role of consumers.