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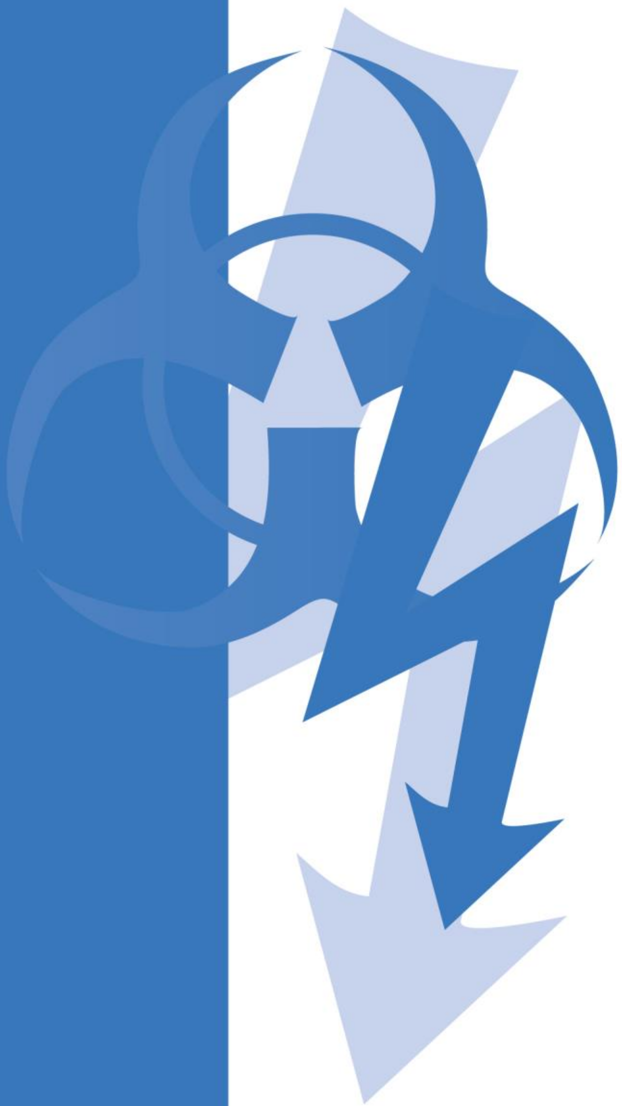

Customer engagement in regulation

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Customer engagement
Towards a new era in economic regulation?

Eva Heims and Martin Lodge

Growing customer engagement is a topic whose time seems to have come. Across regulated industries, regulators are proposing different forms of customer engagement. Of course, ideas about customer engagement are hardly novel – what is novel, at least in the case of the UK, is the encouragement for regulated firms to directly engage with their (various) customers.

In the UK, customer engagement has been advocated as a major departure from existing regulatory arrangements and its innovative potential has been emphasised (Doucet and Littlechild 2006; Littlechild 2008, 2009, 2014). Others have suggested that customer engagement offers, at best, an interesting institutional adjustment *within* existing arrangements. Regardless of perspective, engaging with customer involvement in economic regulation provides critical insight into the ongoing evolution of the British regulatory state (Lodge and Stern 2014).

Customer engagement has been trialled in different sectors across different parts of the UK, ranging from airports, to energy and to water regulation (Bush and Earwaker 2015). Accounts of these experiences vary, but they also highlight the considerable differences in initial design and eventual process across different regulated domains. Considerable differences have been in evidence, whether in terms of the extent to which issues were 'delegated' to the negotiation between customers and regulated firms, the extent to which regulators were 'accompanying' the engagement process, and the extent to which participants in this process expressed their satisfaction with the outcome. What unites these experiences is a shared curiosity regarding the problem-solving capacity of such customer engagement processes.

This discussion paper brings together a number of approaches and experiences in customer engagement, with a special focus on experiences across the UK and different regulated sectors. It draws together a number of key participants to customer engagement processes. It builds on wider debates about the evolving nature of the British regulatory state and, more generally, debates about the future shape of regulation and the role of citizens.

This short contribution focuses on three issues – how the growing call for customer engagement reflects on the fact of regulation in general being in crisis, how customer engagement might be a universally popular term, but arguably for very different reasons, and, finally, how customer engagement processes raise key issues for the role understanding of the different parties involved.

Customer engagement as a response to regulation in crisis

The ongoing debate about how to advance customer engagement suggests that these initial attempts at customer engagement were hardly a one-off set of experiments. At the same time, the contemporary debate points to considerable concern about how to institutionalise customer engagement in regulation, and how to enhance the capacity of such processes to achieve desired outcomes (e.g. CCWater 2014; Customer Forum 2015; Defra 2011; Ofwat 2015). This debate is shaped, on the one hand, by the search for institutional arrangements to offer credible safeguards to all the parties engaged in these processes. Here the focus is on differences between industries, for example, in terms of regulated firms, their ownership structure and levels of entrenched conflict between different parties.

On the other hand, the debate about customer engagement is also shaped by fundamental questions about the role of citizens and customers in regulated markets. The latter concern highlights in particular how the growing interest in customer engagement in regulation can be regarded as a wider realisation that existing approaches are in crisis. This sense of regulation being in crisis and the subsequent interest in customer engagement can be illustrated in three ways:

- Customer engagement can be interpreted as a response to growing dissatisfaction with the practice of existing regulatory approaches that are seen as having increasingly become 'worn down' – as illustrated by extensive gaming and second guessing strategies by regulatory companies and regulators, leading to increasingly complex and high cost processes whose overall effectiveness has been questioned. It is therefore not surprising that it was the regulators who initiated the enhanced role for customer engagement rather than political or ministerial initiatives.

- Customer engagement can also be interpreted as a response to an increasing sense of crisis across regulated industries in terms of their legitimacy. After all, concern with rising prices for utility services or the need to justify major investments have attracted considerable political interest. In such an age of hostility towards regulated industries, customer engagement might offer the promise of enhanced support for pricing and investment strategies. In addition, it might be argued that customer engagement also deals with a sense of crisis regarding customer representation itself as those bodies tasked with representing consumers and citizens are accused of being largely ineffectual.

- Customer engagement can, finally, be regarded as a response to a much broader sense of crisis in the nature of the regulatory state and the regulated firm. Such concerns with legitimacy regarding privatised public services and econocratic regulatory agencies have been long-standing. However, the financial crisis might be seen as a particularly pivotal moment in that it highlighted the limitations of supposedly high intelligence regulation in preventing disaster. Customer engagement might therefore be seen as an

> attempt to re-establish legitimacy for institutional arrangements that have come to be seen as increasingly problematic and under challenge.

More broadly, this concern with the wider legitimacy of regulatory institutions and processes, in the area of economic regulation of essential services, but in broader policy concerns, such as budgeting, or justice systems, has attracted a considerable interest in participatory governance mechanisms (Fung 2015). Any discussion about customer engagement in economic regulation therefore also offers critical insights for those interested in encouraging participation in public decision making, whether this is for reasons of greater agency effectiveness and information, or legitimisation.

Customer engagement – different meanings divided by a common language?

It is commonly acknowledged that the 'acceptance factor' is a crucial part in any adoption of a reform idea. This acceptance factor is largely shaped by a particular term's ability to appeal to different constituencies at the same time (Hood and Jackson 1991; Hood 1998). The same applies also to the term 'customer engagement'. Drawing loosely on the well-established grid-group cultural theory framework (Lodge and Wegrich 2012), it is possible to distinguish between four different rationales as to why customer engagement has enjoyed growing popularity.

For some, customer engagement processes offer the promise of removing regulatory agencies from much of the decision making. If only customers were fully empowered to engage with firms, then it would be in both firm and customer interest to establish negotiated arrangements that would also be monitored by customers rather than bureaucratic actors. Comparisons between different customer engagement processes offer the opportunities for decentralised discovery and learning processes without the need for formal benchmarking by bureaucratic actors, such as regulatory agencies. In other words, customer engagement is seen as a means to an end, namely, one that seeks to reduce, if not eliminate the role of regulatory agencies.

For others, customer-engagement processes offer the promise of a genuine entrenchment of *citizen* interests in the regulated process. Such a view suggests that existing regulatory processes are largely dominated by highly econocratic analysis and well established interests with little concern for customers and citizens. Customer engagement, accordingly, provides for opportunities to include different types of citizen interests (in order to provide for the representation of inter-generational interests). Furthermore, the emphasis is less on *customers* and more on *citizens* in order to highlight the importance of enhancing the publicness of the regulatory process in essential public services.

For others, again, customer engagement offers the promise of dealing with the growing disillusionment and fatigue that surrounds existing regulatory arrangements. According to this perspective, any regulatory approach will eventually run out of steam, and customer engagement is a novel perspective to force regulated firms to be responsive to customers, if only by taking their customer surveys and complaints more seriously.

Finally, customer engagement might also be regarded as enhancing the quality of existing regulatory decision making processes. It offers one way of increasing the information basis on which regulators depend by including a different form of challenge and consultation forum to existing regulatory processes without necessarily challenging the primacy of the regulator in making final determinations. Furthermore, it arguably offers a 'cheaper' way for regulators to monitor consumer complaints and involvement as such tasks are delegated to specific customer engagement groups.

Table 1 summarises these four perspectives. Each offers contrasting rationales for advancing customer engagement. However, it is unlikely that representatives of these perspectives will come to any long term agreement as to the functioning of customer engagement, leading to inevitable disappointment and criticism

Table 1 Four perspectives on customer engagement

Enhanced responsiveness Customer engagement has novel opportunity to force regulated firms to engage with customers	**Enhanced regulatory decision making** Customer engagement as enhancing regulatory information basis and reducing regulator's need to monitor regulated firms
Enhanced decentralisation Customer engagement has opportunity to reduce, if not eliminate, need for regulators	**Enhanced publicness and citizen involvement** Customer engagement as enhancing citizen involvement and publicness of regulated industries

Each of these perspectives also points to potential pitfalls that may affect customer engagement processes. Accordingly, an over-reliance on firms negotiating directly with customers might bring the risk of particular, i.e. well represented, customers to dominate the engagement processes without sufficient safeguards that other customer groups would be sufficiently represented. Furthermore, eliminating agencies also brings the growing risk that firm interests will eventually outgun customer interests as firms exploit their inbuilt information advantages over customers.

Similarly, too much reliance on citizen involvement might be argued to encourage 'populism' as customers might be particularly interested in price reductions today rather than long term investment. Others may see customer engagement as a largely ineffective means to force regulated firms to engage firms with their customers. Rather, firms will maintain their primary reliance on privileged access to regulators (and the world of politics) to ensure that their interests are well represented, especially as increased attention to customers is likely to reveal the highly volatile nature of customer preferences in these sectors.

Finally, the view that customer engagement enhances the quality of regulatory processes is open to its own source of failure in that the need to closely monitor customer-engagement processes reduces their ability to innovate and, inevitably, become highly rule-bound exactly at the same time as overall interest in participating in such processes withers away. Table 2 summarises this argument. It is not that any one of these pitfalls will inevitably occur, but that any particular emphasis in the design and practice of customer engagement processes is likely to increase the likelihood of such perverse consequences.

Table 2 Four perspectives on pitfalls in customer engagement

Fig leaf Customer engagement process fails to enhance firm responsiveness due to presence of well-established channels of influence	**Juridified withering away** Customer engagement processes lead to increasing rule-bound processes with reduced engagement over time
Firm dominance Customer engagement processes enhances the information asymmetry of firm over customers and regulators	**Populism** Customer engagement processes adopts short-term populist perspectives and excludes wider and econocratic considerations

Customer engagement and institutional implications

Finally, then, what are the institutional implications for the different parties involved in customer engagement? The most immediate challenge is for regulatory agencies themselves. Regardless of the underlying rationale for customer-engagement processes, the role of regulatory agencies is challenged by the delegation of negotiating power to bodies tasked with representing customer interests. Even in those cases where the regulator remains formally in charge, there is a trade-off between, one the one hand, encouraging 'active' engagement between firm and customer representatives by committing the agency to respect the outcome of these engagement processes and, on the other hand, the concern that too much delegation will lead to 'weak' outcomes.

A second challenge is how regulators are to support customer engagement. The experience of customer engagement in the Scottish water sector suggests that one of the most critical ingredients of the widely shared perception of a successful process and outcome was the background support of the relevant regulator (WICS) for the customer representatives, the Customer Forum. Such a bespoke advice role is less feasible in the context of multiple regulated firms where companies might be particularly concerned about 'uneven' advice. More generally, customer engagement forces regulatory agencies to become venues for mediation and negotiation, something that sits uneasily with bodies that seek to establish their reputation through hard edged competition-driven economic analysis.

Customer engagement also has considerable consequences for bodies devoted to customer-rights advocacy and representation. Direct engagement in regulatory processes considerably stretches the resources of such bodies, and the technical knowledge about economic regulation may not be available, especially over the long term. Such challenges therefore call for more resources for such consumer bodies – something rather problematic in an age of financial austerity. More fundamental, direct engagement processes also pose a challenge to the core mission of customer advocacy bodies. Their function is to challenge and criticise companies and to represent customer interests. Dealing directly with companies and haggling over business plans and the design and interpretation of surveys that supposedly reveal customer preferences might be seen as a 'dangerous' departure from the original mission of such bodies.

Finally, regulated firms are also challenged by customer-engagement processes. After all, such processes disrupt the, by now, well established 'regulatory conversation' between firms and regulators. More fundamentally, they also point to difficult trade-offs on behalf of the firm. One is that it requires firms to identify relevant customer representatives – such identification processes might be less tricky in regulated services, but become more difficult where relevant 'customers' are more complicated to identify – such as in transmission networks. A second is the difficulty of establishing what customers actually want, which leaves companies with unresolved conflicts over difficult trade-offs between long term investment plans to establish 'security of supply' which inevitably leads to being accused of 'gold-plating', and calls for cost reductions which, in turn, will be criticised as 'asset sweating'.

It is not argued here that institutional actors should not be stretched and to reconsider their role. Rather, the argument is that customer-engagement processes do pose considerable strain on existing actors and that any debate about the future design of such processes needs to consider the implications for the parties concerned.

Conclusion

This short contribution highlights some of the implications of the increased interest in this field. It has been argued that customer engagement is an important trend and one that is unlikely to fade away in the medium term future as it represents a useful recipe to address the varying sets of diagnoses of crisis in regulation. However, these processes are faced by inherent tensions regarding different rationales and they pose considerable challenges to the key actors involved.

As customer engagement becomes entrenched in the regulatory landscape, it is inevitable that these tensions and challenges will become increasingly prominent as such processes are further trialled and implemented. Customer engagement may offer an important remedy for dealing with some of the existing problems in the regulation of key economic sectors, but its potential to introduce its own tensions and dynamics should not be underestimated.

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Customer engagement

Stephen Littlechild

Customer engagement has spread remarkably throughout the regulation of the United Kingdom's gas, electricity and water networks. Yet only a dozen years ago only two people in the country were exploring that concept as we know it today. One was Harry Bush, inventing the concept (as constructive engagement) in airport regulation at the Civil Aviation Authority (CAA). The other was myself, talking to everyone who knew about it outside the country, mainly in North America but also in Argentina.

The UK concept is novel. It adapts North American negotiated settlements to include a significant role for the regulator in determining some, but not all of the parameters of the price control. It is proving attractive in yet other countries too. I talked about the approach in Australia and New Zealand this summer and in Ontario (Canada) just last week, and all have expressed great interest in this approach.

Why did the idea catch on so fast? Partly because the concept seems to have been attractive to companies, customers and regulators; they often said it was 'the obvious next step in regulation'. And partly, because over time an increasing number of examples of it working were fed into local discussions, so that it became a practical option, not a theoretical possibility.

The idea that the role of the regulator might be to facilitate the market process rather than to take all the decisions now, seems to me, indeed, an obvious as well as an attractive one. But if it was such an obvious and attractive next step, why did we not see and adopt it earlier? In the 1980s Michael Beesley and I spent many hours – years – discussing privatisation and regulation, but this idea never occurred to us. In the 1990s I must have been involved in about 50 electricity sector price controls, and again the idea never occurred to me. Why not?

One reason is that the North American experience of negotiated settlements that so attracted me when I discovered it in the 2000s was still in its infancy in the 1980s and 1990s. It was not reported in the textbooks or in journal articles, apart from the honourable exceptionof the less known PhD thesis of Paul Joskow (1972) PhD thesis.

A second reason is that we didn't yet realise we had a problem to which the answer was customer engagement. In the 1980s and 1990s it seemed natural and effective for regulators to set price controls after hearing the views of companies and customers. Typically, the process took only a year or so and yielded significant price reductions and quality improvements. It was not until the 2000s that the full awfulness of the price control review process began to be apparent. By that I mean the disadvantages noted by Ofgem in its RIIO review[1], including the time taken – by then more like three or more years to set a five-year control – and the cost and complexity involved, the lack of incentive for good business plans, and the focus of companies on the regulator rather than the customer.

Perhaps a third reason was that the focus in the early years was on increased efficiency, which did not need much customer input. Over time the emphasis changed to discovering and meeting customer preferences, which did need more customer input and left the regulators more exposed.

What of the future? Harry Bush and John Earwaker (2015) have produced a tremendous evaluation of the experience of the four regulators CAA, Ofgem, Ofwat and WICS. Their recommendations for an improved process next time seem to me very well grounded. They identify three broad approaches: (a) for a somewhat more conservative approach to customer engagement; (b) for something along present lines; and (c) for something more adventurous. I confess that my preference would be for an option (d) – giving companies and customer groups maximum scope to negotiate agreements. But bearing in mind though not constrained within guidelines laid down by the regulator. As I have set out elsewhere, I should like to envisage the possibility of competition between company and customer groups in setting price controls (Littlechild 2014: 152–61).

Let me instead focus on two issues that are noted but not explored in detail in the above report. The first is the suggestion that certain issues – notably cost of capital and future cost efficiencies – should be left to the regulator because it has a comparative advantage there. This is because it has economies of scale as it would be more costly for a dozen separate customer groups to carry out the necessary research – and it has legitimacy as a body appointed by customers to represent customers.

But CC Water in the water sector also has economies of scale and also has legitimacy. So why should priority be given to one or the other statutory bodies? My tentative inclination would be to encourage a customer body to undertake such research and provide advice, with the role of the regulator focusing on resolving disputes in the event of failure to agree.

The second issue is that regulators might not always be enthusiastic about customer engagement. Some commissioners might ask whether they should delegate their powers and responsibilities to an ad hoc customer group. Surely, they would say, it is our job to interpret the needs of customers and to determine trade-offs such as between quality and price. This view from commissioners might manifest itself at the beginning, middle or end of the price control review process, perhaps unpredictably.

This is an understandable view, but if the role of customer engagement is to be developed, as I believe it should be, then commissioners need to be informed and

[1] RIIO stands for Revenue = Incentives + Innovation + Outputs.

assured that their role is to facilitate customer engagement rather than to pre-empt it by taking all decisions. The Alberta Utilities Board Act 1995 has an important provision, specifying that 'the Board must recognise or establish rules, practices and procedures that facilitate negotiated settlement'. We might consider adapting this to the GB context, for example by requiring that 'the regulator must recognise or establish practices and procedures that facilitate customer engagement, and more generally agreement between licensees, users, customers and customer representatives'.

I am tempted to go further, to suggest that regulators should not be allowed to impose regulations unless they have previously sought to encourage negotiated settlements to similar effect, but perhaps that is for a later time. For the moment, the main thrust of policy ought to be to require all regulators to facilitate customer engagement. That is progress enough for the moment.

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Consumer engagement in regulation
What does good practice look like?

Trisha McAuley

The role of regulators

Regulators need to make accountability real by delivering outcomes for the people they serve. However, you cannot deliver an outcome focused approach if you do not know what the people you serve think, need and want. Moves, therefore, by regulators over the last few years to increase and enhance the involvement of consumers in regulatory processes are very welcome, as is the recognition that consumers are not just the prime beneficiaries of regulation but are co-producers. Having said that, it remains somewhat disappointing that, here in the 21st century, consumer engagement in regulation is still seen, largely, as being innovative and that conversations such as this are still necessary.

I have deliberately used the word ‘consumer’ here instead of ‘customer’, as the latter implies an existing, transactional relationship. But effective engagement needs to go beyond existing customers and identify all those affected by regulatory and policy decisions. It needs to reach out to consumers who cannot access the market but would like to, and indeed, need to. It needs to consider the critical trade-offs that will have to be made in meeting the needs of current and future consumers.

The regulators have employed different mechanisms and structures to engage with consumers and there have been clear reasons for those differences in terms of the purpose and the scope of the task. For that reason, not one approach is any better or worse than another. I do believe that more needs to be done jointly, and strategically, by regulators to bring together and highlight best practice in consumer engagement across regulated industries and markets in the UK. Sometimes I see regulators criticising each other and sometimes I see consumer engagement being viewed as some sort of competition between regulators – that does nothing for public trust or consumer confidence.

Regulators have a key role to play in driving consumer engagement processes in markets. But, no matter what consumer engagement structures they have, longer term change will not happen unless they can ensure they have put in place the right organisational culture and commitment. Without this, consumer engagement will be an add-on only, when it should actually be embedded throughout the regulatory business. It needs to be integral to any corporate strategy and at the heart of policy and delivery. It needs Board level leadership and commitment. It needs clarity of purpose. That purpose should be for consumer engagement to have a genuine and visible impact on policy. It recognises consumers as experts with the insight and expertise which can help policies to respond better to need.

While there are many excellent examples of consumer engagement in regulation I would suggest that more needs to be done to mainstream the consumer perspective into regulatory strategy and delivery and in the regulatory values and systems that support it.

It is important to understand and accept that high quality engagement improves the quality of decision making, and builds trust with the public. Engagement means genuinely influencing decision making. Do not engage if you cannot guarantee that the contribution of consumers or their representatives will make a difference. Regulators need to be clear about what they mean by engagement and understand the spectrum of participation and the differences between informing, consulting, involving, collaborating and empowering.

Clarity of purpose is critical and regulators need to engage at the very earliest stage of policy development – long before a price control review starts, not after they have already determined its shape and structure. We need consumer involvement in the design of consumer engagement structures. The regulator cannot act in isolation. This needs real partnership with consumer bodies and their active involvement upstream to co-design the best possible form of engagement going forward. It needs stakeholder buy-in and trust. Regulators need to listen and build consensus.

The regulator should know and demonstrate the impact of consumer engagement on its decision making processes. And commit to transparency when it rejects or fails to act on advice from the consumer group, and give clear reasons why. Regulators need to keep thinking about the future as appropriate models of consumer engagement that will always change. Agile regulation looks to alternative regulatory business models to reflect evolving consumer experience and need.

Consumer engagement – institutional arrangements

There are two key inter-related aims – improve regulatory outcomes and increase public legitimacy. The growth of interest in how citizens can participate is a direct response to a perceived lack of accountability. It is therefore critical that accountability is followed through in the institutional arrangements and delivered, and seen to be delivered, in practice. What are the elements that make up legitimacy and accountability?

A publicly available governance document is critical. The parameters of the task in hand should be defined at the start, and agreed by all parties. Lack of clarity runs the risk of mission creep, causing confusion, altering outcomes and doing nothing to manage public expectation or consumer confidence. There needs to be an agreed purpose, direction of travel and business plan.

Consumer interest representatives need to have actual involvement in regulatory decision making. They need to truly be seen as equal participants along with other interested parties and be involved at the same, and earliest stage of the decision making processes. They need equal access to decision makers.

Be honest about the actual involvement of customers/consumers and honest about their representativeness. A consumer interest representative is not the same as a representative consumer. A customer engagement group cannot possibly represent all consumers. So it, and the regulator need to need to be honest about these limitations – honesty where customers are not involved and have not agreed or made decisions. Do not over-claim that customers are engaged when they have not been.

Consumers, rather than stakeholders, should be round the table. They are not the same thing. And there should be no vested organisational or personal interests.

Resources to do the job properly goes without saying – a shoestring operation will have no credibility and no authority.

Absolute independence is critical – be honest about that! The regulator needs to let go – can it really do that? We need to see honesty about those tensions.

It is the role of consumer advocacy to be partisan whereas regulators will have to balance a range of different interests and evaluate the costs against the benefits of any regulatory decision. The approach to consumer engagement needs to be, and seen to be, truly independent of the regulator. Is it perceived to be independent by *consumers*?

There needs to be clear, unbiased management of the process. The regulator needs to build the capacity of, and provide support to, the consumer representative body. But it must do so without compromising the independence of the consumer engagement and input. It is critical to get that balance right. The approach to consumer engagement should also be truly independent of and separate from the regulated business(es). Do consumers see it that way? How do you know?

The consumer engagement group needs to work in partnerships with the regulator and the industry but it cannot and should not get too close. It has a role to offset regulatory capture and therefore it is critical that it too does not become captured. Regulators therefore need to be clear and honest that that consumer interest representatives have not been ‘captured’ by the regulator themselves or the regulated business/industry. They need to show how they have worked to avoid that capture. For example, who provides market and regulatory information to a consumer group? How is that information framed? Distinguish, and be clear, about what is information, what is advice, what is guidance and what is direction – and be very clear and honest about what is appropriate and what is not appropriate, what is biased or one-sided and what is truly independent information.

The same principle applies to direct engagement between the parties involved. Behind the scenes, discreet conversations, often over lengthy periods, based on individual or small group relationships can run the same risks regarding capture. Structured corporate support is essential as opposed to reliance on personal knowledge and behind the scenes conversations that lack transparency when difficult decisions have to be made.

Looking outwards is critical for the consumer engagement body. Stakeholder buy-in is important as is engagement, listening and working with consumer organisations, learning from their expertise on good practice, and avoiding duplication.

Accessibility and visibility are essential. A consumer engagement structure will only be credible if it operates on the basis of a robust, independent research evidence base.

But it also needs to listen to consumers. Legitimacy is derived from meaningful engagement with its constituency and from a strong research evidence base. Consumers are not homogenous. Regulators and consumer interest representatives should know who their consumers are and the diversity of that base. And have a clear plan for finding them and for what they will do if they are hard to reach. Be very aware that those who are the most likely to participate are not always representative. You need to engage with those least likely to participate in the market – usually the most vulnerable who could benefit the most.

Is the public informed about its work? Consumers need to know who is acting on their behalf and what they are doing. Consumer groups need to make themselves accountable to consumers. Transparency is vital in ensuring public trust in decision making. The wider public needs to see what is going on and how decisions are being made. Consumers need to know what is being done in their name – this impacts on the trust agenda. If it is not present in consumer engagement structures then that trust is even harder to win. The reputational challenge to consumer bodies is much bigger.

Coming to negotiated settlements – I am wholly in favour of any means to increase and enhance consumer involvement but we need to be honest about what is being delivered. Is it going to be different from the traditional regulator/company interface – or just a different form of negotiation, trade-off or compromise – it's still a negotiation rather than a clear informed, stand-alone consumer position. Is it a downward negotiation or a consumer-driven decision?

And consumer engagement does not stop once the business plan or price control have been agreed. The aim should be for it to be embedded in the culture of the regulated business, bringing about long term consumer-centric culture change – so you don't have to start all over again at the next price control review. They should accept and recognise that empowering consumers brings benefits to the business and therefore that it is neither an onerous burden nor an expensive add-on.

The consumer engagement groups needs to be able to define and measure its impact on consumers in terms of outcomes.

Has it addressed real market failures?
Has it increased regulatory accountability – and seen to be doing so?
It should ensure that its work is evaluated independently.

Expertise and support

As above, consumer interest representatives need equal access to information from the regulator and the regulated in a form they can use. All steps need to be taken to avoid decision making bias or capture. Any third party advisor needs to be independent of the regulator.

Members need to possess the ability to analyse and make sense of complex information and then be seen to be asking the difficult questions and challenging accepted wisdom. They need to be consumer interest experts. They need to be able and equipped to identify likely sources of consumer detriment now and in the future, to be confident that they are effectively exploring the needs of existing and future consumers and discussing robustly the short and long term trade-offs that will need to be made as a result. They need to have strong powers of analysis and a track record in applying sound judgement and making robust decisions.

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Why customers need an institutional voice in regulated sectors

Roger Darlington

How do individual customers and companies engage with one another?

In *all* markets, there are at least six main methods:

1. Marketing – the promotion of products and services;
2. Sales – one-off or subscription;
3. Complaints to companies – these start as negative but can be learnings for the company;
4. Public comments on social media or forums;
5. Qualitative research such as focus groups or citizen juries;
6. Quantitative research – but different questions, different sample sizes, and different timing can all influence results.

All these are valuable forms of customer engagement which all companies and providers should be using.

In *regulated* markets, there are at least three further mechanisms:

1. Often there is an ongoing relationship with regular billing that might be monthly, quarterly or yearly – but evidence suggests that customers only look very quickly at bills simply to confirm charges.
2. Switching provider – but there are low levels of switching and, in some sectors, switching levels are actually falling.
3. Engagement with regulatory debates and submissions to regulatory consultations – but this is very difficult for customers who have busy lives and lack knowledge of regulatory issues and even language.

Yet, in regulated markets, customers need strong engagement because:

1. There is limited or no choice of provider.
2. We are talking about an essential service that no home can do without.
3. The sector has high costs because of heavy and long term investment needs in infrastructure.
4. There are complicated trade-offs to be made between different stakeholders.

So customers/consumers/citizens/users need a stronger voice than markets alone can provide and this needs to be an *institutional* voice in regulatory debates.

The different models for an institutional voice
There are three models for providing an institutional customer voice in sectors subject to economic regulation:

1. A body *within* the regulator – such as the Communications Consumer Panel in Ofcom, the Customer Panel in the Civil Aviation Authority, and the Customer Advisory Panel in Ofwat for Price Review 14.
2. A body *outside* the regulator – such as the former Postwatch and former Energywatch which were merged to form Consumer Focus and then became a unit in Citizens Advice plus bodies like CC Water and Passenger Focus
3. A body *within the regulated company* – such as the Customer Challenge Groups in the 18 water and sewage companies in England and Wales and the External Advisory Board in mobile operator EE.

I am very familiar with all three models:

1. A body within the regulator – I was the Member for England on the Communications Consumer Panel for eight and a half years.
2. A body outside the regulator – I was on the Council of Postwatch for its last three years and on the Board of Consumer Focus for its first three years.
3. A body within the regulated company – I have chaired the Customer Challenge Group for South East Water for four years and I have been a member of the External Advisory Board of EE since it was set up two years ago.

In my view, each model has its strengths and weaknesses. So I believe that the best approach is a combination of all three with clear definition of roles, close working of the parties, and proper resourcing for each body.

Need for cross fertilisation of the customer experience
Although each regulated sector has its own characteristics and complexities, there are some common features of all regulated markets. The regulators work together through the UK Regulators Network. Customer bodies similarly need to work together across sectors. Three relevant customer bodies are:

1. The Consumer Forum for Communications (which I chair) that covers telecommunications, broadcasting, spectrum, and posts;
2. The New Public Interest Network that covers energy and water;
3. The Essential Services Access Network that covers energy, water, communications and financial services.

Some examples of the many cross-sector issues to be discussed include: access, take-up, price controls, affordability, vulnerability, switching levels, complaint handling, alternative dispute resolution procedures.

How do customer bodies reach their views?
Like the regulators themselves, customer advocacy bodies need to be as evidence-based as possible. There are potentially many sources for evidence including the regulator's research, the sector body's research, the company's research, complaints data, and research by customer bodies including all those already mentioned plus Citizens Advice, and Which? However, all data has its limitations and many regulatory decisions do not lend themselves to customer research alone but require detailed knowledge and careful judgement.

Finally, we need to recognise the inevitability of trade-offs and make these as explicit and transparent as possible:

- between different customer groups;
- between present customers and future customers;
- between customer and citizens.

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Customer engagement in regulation
Let's start with the customer

Sharon Darcy

Customer engagement is generally seen as a 'good thing'. Most regulators now spend significant resources engaging customers in their key decisions and have increasingly required regulated companies to do the same.

The reasons to engage customers in regulation are well rehearsed. When there is monopoly power or market failure, the regulator frequently acts as the proxy consumer. To be evidence based and credible, regulators need to ask customers what sort of services they want or to get regulated companies to do the same. When there are significant information asymmetries, involving some customers in the design of services can lead to better outcomes for all. Customer engagement can also help ensure that the right approach is taken to meet the needs of people in vulnerable circumstances.

Being clear about why customers should be engaged in a decision is an important first step to deciding what sort of engagement mechanism is appropriate. Similarly, seeing this from the point of view of the customer rather than the regulator (or provider) is essential if the process is to really add value.

Five meta-trends are now influencing customer engagement across the economy. Regulated sectors are not exempt and due to the essential services that they frequently cover, may face some unique challenges. The first two of these trends are technical. Digital communications are leading to increasing pressure for more timely engagement and more varied, open and ongoing relationships between customers, regulators and providers. In this context, formal engagement processes need to evolve if they are not to be seen as clunky, remote or unresponsive. Companies may be better placed than regulators to fulfil this new role but safeguards and incentives may be needed.

Secondly, smart technologies (such as domestic photovoltaic panels) can enable customers to self serve, become 'pro-sumers' or develop new collaborative approaches. With the move towards DIY technically enabled solutions to service problems, what was often a monolithic customer base can become fragmented. Different customer segments may increasingly want different outcomes. Customer engagement processes need to be receptive to these different voices but also take into account that they can have significant distributional impacts if increasing cost-reflectivity leads to the unwinding of cross-subsidies. Involving customers in decisions around how the balance of different interests is struck, and how customers in vulnerable circumstances may need to be protected, is important.

The third meta-trend is social, and is largely a consequence of the first two. Customer expectations are changing rapidly. The increasing demand for more social, mobile, and local services inevitably adds to the call for more bespoke and tailored approaches to engagement. The democratising impact of new forms of communication enables groups and communities that were not previously able to get their voice heard to do so. It is also changing the sphere of reference that customers can have about a particular service. Rather than just comparing one water company's customer services with another's, for example, consumers are likely to compare them with the best service providers they have used – irrespective of the service delivered. In this context, regulatory engagement mechanisms may need to adapt to take a far less sector by sector approach and to become more customer- and community-centric. This can also help overcome problems around 'consultation fatigue.'

The shrinking state and continuing drive to focus policy on market rather than state led solutions and reduce red-tape is the fourth, and most political, meta-trend influencing customer engagement. Giving customers a greater say in what previously may have been micro-managed activities clearly brings many benefits. However, if the focus is too much the other way, and an individual approach is always given precedence over collective solutions, it may similarly be sub-optimal. This may particularly be the case in complex networked services that, due to long asset lives for example, may require a more strategic approach. Getting a collective long term customer perspective here would seem important. Alternatively, in services where policy costs are being met by bill payers rather than taxation, it may be necessary to have an approach to engagement that recognises that these issues may have a citizen as well as a consumer perspective. Without this, concerns around a democratic deficit in decision making may develop. To effectively involve customers in such issues may require the use of more deliberative or empowered types of engagement, such as citizen juries or negotiated settlements.

The decline in trust and confidence in many regulated sectors – ranging from banks and energy firms to healthcare providers is the final trend that is shaping customer engagement. In such a context, engagement mechanisms need to address both the challenge of maintaining the social licence of regulated firms to operate and the legitimacy of regulatory frameworks. Ensuring that those involved in engagement processes are 'legitimate' representatives of the customers and communities that they speak for is important. Diversity is crucial here: of experience (be this of different customer segments, citizens or environmental interests); life stage (current and future users); and ways of thinking (cognitive diversity). Independence from companies and providers is also important. For this to be real, the resourcing of customer engagement approaches needs to be given due attention. Without providing adequate financial support, customers and their representatives may be unable to make the commitment to stay the course for what can be long and involved regulatory decisions. This can create a mismatch in expectations that could undermine the positive contribution that customer engagement can make.

Over the last few decades, the pace of change in customer engagement in regulation has been relatively slow. The five meta-trends explored here could start to change this. There clearly are available a myriad of techniques and approaches to engagement. However, it is important to start from where the consumer is. The basic guidelines in the following checklist may help. As the five trends become a new reality, it is important that approaches to engagement continue to evolve. Sustainability First's New-Pin'[*] is a step in this direction.

Effective engagement checklist for regulators and companies

1	Objectives	Why do you want to engage? Are you clear what outcome you want and what success looks like?
2	In the lead?	Should the regulator, company, trade body or a third party be in the lead? For some decisions, it may be more effective for other bodies beside the regulator to engage customers.
3	Stakeholders & audience	Are you involving the right people? Have you carried out a stakeholder mapping exercise? Are you engaging a sufficiently diverse group of customers?
4	Nurture	Have stakeholders the appropriate resources to engage? What can you do to help facilitate this and build capacity?
5	Embrace	Have you 'thought big' and engaged in a timely fashion and given a route in to those engaged to senior decision makers?
6	Mix & match	Have you used the most appropriate range of engagement techniques to help you achieve your objectives?
7	You said: We did	Have you explained the reasons for your decisions and why you have/have not acted on the in-puts from the engagement process?
8	Ongoing impact	Have you asked for feedback, measured impact, made any necessary changes and embedded good practice?

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[*] Sustainability First's New Energy and Water Public Interest Network ('New-Pin') is a network of regulators, companies and public interest advocates (consumer, citizen, environment and investor groups) established to explore long term public interest issues in energy and water. Examining the similarities and differences between the two sectors, New-Pin seeks to develop: a clearer alignment between stakeholder views and build a better understanding of any differences; capacity and expertise amongst public interest advocates; and understanding amongst boards of the value of public engagement and what successful engagement looks like. For more information see <www.sustainabilityfirst.org.uk>

Regulators and consumer engagement

Richard Moriarty

We are all customer focused now …

A consistent theme of regulation over the past decade or so has been how regulatory authorities encourage their regulated communities to be more customer focused. I'll use the word customer here as shorthand to mean the end user, as different regulatory regimes have different terms for the end user: consumer, customer, the public, client, passenger, patient, tenant, etc. This policy direction has in some sectors been supported by legislative changes to give regulators a primary duty towards the customer (as is the case with the recent Aviation Act 2012).

Regulators have been particularly keen to ensure their regulated communities understand the needs of customers and develop services that meet those needs. Although much of the focus has been on the field of economic regulation (e.g. water, energy, and aviation), this trend has also been evident in other forms of regulation such as professional conduct regulation (e.g. legal services and healthcare) and prudential regulation (e.g. financial services and social housing).

Often with similar strategies …

Customer engagement is quite a broad canvas. In the main, regulators view active and assertive customers as key to the health and vibrancy of the market they regulate. Regulators have adopted a fairly similar approach. They have developed 'demand side' interventions usually under the banner of 'empowering customers through better information' about their rights, service providers and the market. They have also sought 'supply side' interventions aimed at encouraging regulated companies and professionals to take more interest in the views and needs of their customers. Finally, regulators now routinely undertake customer research themselves and many have customer panels and similar bodies to advise them on policy development – some of these panels are statutory bodies (e.g. legal services, communications) and some non-statutory (e.g. aviation).

I will focus on one aspect that has received a lot of attention lately – what I called the 'supply side' interventions or in plain English how regulators go about encouraging those that they regulate to be more responsive to their customers.

Regulators sometimes have different motivations for customer engagement

It is worth reflecting on the reasons regulators have given to support this type of intervention.

- In some cases there is a classic monopoly or market failure rationale. Although expressed with more diplomacy, the regulator thinks that the companies with a monopoly position cannot be trusted to understand and serve consumer interests well (e.g. water and energy network businesses). But the regulator is also conscious that it itself is also a poor proxy or substitute for local customer preferences. So it imposes a governance framework for how the monopoly business should engage with its customers.

- Some regulators have also seen greater customer engagement by regulated companies and professionals as a way of reducing the role for direct regulatory intervention by making Boards of companies much more accountable (e.g. social housing and water). Regulators in these sectors have observed that those they regulate spend a disproportionate amount of their time managing their relationship with their regulator compared to managing the relationship with their customers. The regulator in effect is attempting to encourage a cultural change.

- Outside the sphere of economic regulation, there are other regulators that have pursued greater customer engagement as a supply side intervention. The motivation often being that even if the regulated companies or professionals are generally active in an open market, they may not always have the right incentives to sufficiently protect or promote customers' interests (e.g. certain financial services) or where there are significant asymmetric information barriers or personal consequences that cannot be addressed with regulatory remedies after the event (e.g. legal services and healthcare).

There is broad support for customer engagement to continue

Within the context of economic regulation, the general feeling of most stakeholders that I have spoken to, or read about, is that the move towards greater customer engagement is very welcome and it has delivered value.

During the recent Ofwat price review of the English and Welsh water companies, I worked with one such company and know from my first-hand experience how our business plan priorities were shaped by an intense process of customer and community engagement. Our balance of investment priorities between reducing leakage, investing in new water sources, and the ultimate cost to bill payers would have been different had we not engaged our customers in the way we did. It would have also been very different had we had a more traditional regulator-led settlement driven by Ofwat focusing on the outputs it thought our company should have delivered to our customers.

An important point here is that by forcing us to reflect on our customer priorities, Ofwat subtlety enabled our Board to focus outwards towards our customers and communities and therefore own *our* business plan; and so it did not feel the plan was somehow imposed upon us by Ofwat as had been the case in the past. This was a small but hugely psychologically important point.

Inevitably with such a new regulatory process there have been lessons learnt. The view, however, of many regulated companies and consumer bodies is that they would like to extend the process of customer engagement even further for the next round of periodic price reviews. This undoubtedly raises the question of how such processes should be designed in future reviews.

Six observations to help shape future customer engagement processes

I would like to offer six practical observations or recommendations based on my experience of seeing how the process works across various sectors, both from the point of view of being the regulator and the point of view of working for a regulated company. I should stress that I have also been greatly influenced by a recent report written for UKWIR by Harry Bush and John Earwaker (2015), which examined in quite some depth the lessons learnt from the last Ofwat periodic price review.

I – Be clear upfront what role you want customer engagement to play in the regulatory process

First, and perhaps most importantly, the regulator has to be clear right at the start about the 'weight' it wants to place on customer engagement in its periodic review process. This is important to manage expectations of market participants and also guide the skill set and behavioural characteristics required by the regulator in the course of the process.

The Bush and Earwaker (2015) review for UKWIR presented three options the regulator could adopt in differentiating each option according to the weight the regulator wished to place on the outcome of the customer engagement process. A complementary way of describing the choice set facing the regulator is to think of there being a spectrum of possibilities for how it treats customer engagement.

- At one end of the spectrum (the 'shallow end') the regulator can view customer engagement as a consultation exercise, e.g. in requiring companies to consult their customers in formulating their business plans – perhaps this is best characterised as the traditional approach. Many regulatory standards or licence conditions obligate companies to consult with their customers. Customers' views are just one input the regulator takes into account before it calculates the price determination, and often after quite detailed and technical analysis.

- Moving along the spectrum, the regulator could place a greater weight on customer engagement by requiring companies to gain assurance or sign off from a consumer panel/group or a similar body. Under the this approach, the regulator can rely on the assurance provided by the consumer panel/group rather than have to undertake its own intrusive investigations about customer preferences at the local level. This approach was perhaps best exemplified by Ofwat in its recent periodic price review for water companies in England and Wales. Water companies were required to gain assurance from independent consumer challenge groups (CCGs).

- At the other end of the spectrum (the 'deep end') the regulator could view itself as a facilitator of a negotiated settlement between the company and its customers – this is something that the water regulator in Scotland has done in its recent review of Scottish Water's charges. It requires the regulator to be pre-disposed to accept the outcome of the process and how to ensure fair play between the regulated company and the consumer panel/group where the former may have significant market power and access to information and resources not available to the latter. This approach also requires a degree of trust and confidence among the principal parties involved. Stephen Littlechild (2014) has written extensively about how this approach could be a superior alternative to how UK regulators have traditionally undertaken price reviews.

II – the regulator should clarify its expectations about how customer engagement should be conducted and the roles and responsibilities of the parties involved

Having decided upon the weight it wants to place on customer engagement, the regulator can help the process by being clear what type of governance process it expects and the roles and responsibilities of the key players. Some regulators have tended to be specific and have required purpose built bodies to be established, such as the aforementioned customer challenge groups that Ofwat mandated or the constructive engagement groups that the CAA established. Experience has taught us that being clear on the practicalities really does matter and the regulator communicating its expectations greatly helps. Having clear objectives, terms of reference, timetables, and so forth is critical to success and momentum as is making sure the group has the right governance, members, resources and information to do the job effectively. Participants also need to know what it is in scope and out of scope and any important legal or policy 'boundaries' that should set the context for the discussions.

I would make the following observation on consumer panels, which I appreciate is from my own experience so others may take a different view. I have found that they yield most value when their role is to provide *assurance* that proper account has been taken of customer views rather than to *represent* customer views themselves. This is a subtle but important distinction. If panels are supposed to represent customers, then there is a real question of how they gain 'legitimacy'. There is no such thing as *the* customer as customers tend to be a very heterogeneous group. What about 'difficult to engage' customers? How are the customers of the future to be represented?

III – the regulator should be clear on its role in the customer engagement process especially in relation to information provision

The regulator will have to adopt a different mode of working if it is facilitating a negotiated settlement than if it is determining the outcome; the former requires careful thought about what and when information is provided as well as skills in shuttle diplomacy.

With the exception of the example for Scottish Water mentioned earlier, most regulators tend to sequence their reviews with the customer engagement process taking place before the regulator determines some key parameters. I have some sympathy with the argument that the customer engagement process could be strengthened by the regulator making some information available earlier in its process to guide participant expectations, especially if the regulator has access to comparative or benchmark data that the customer group would not have access to. This also helps guide the outcome of the customer engagement discussions to a place that is within the tolerance range of the regulator.

IV – incentive mechanisms may have a role to play

The regulator should consider whether there is a role for incentives to reward/punish companies in how seriously they take customer engagement. I appreciate this is tricky territory because what regulators want to see is that there is a genuine culture of properly taking into account customer views, not that the company only does it to tick a box for its regulator.

Incentive mechanisms may in certain circumstances help. These do not need only to be financial incentives. I am quite attracted in some sectors to the power of reputational incentives. I have found that many CEOs of regulated companies like being at the top of their regulator's 'league tables', even if they have little idea what that league table actually is! Process incentives can also be used. Offering a company a lighter touch regulatory review (or fast tracking) as a result of it being good at customer engagement is a win-win that could be considered. This does, however, raise the question of how the regulator judges a company is good at customer engagement, which is not something that usually gets taught on economic regulation training courses.

V – the process needs to be mindful not to frustrate the potential for innovation and competition

The regulatory design for customer engagement should be very conscious not to close in or frustrate the space for innovation within the regulated sector especially if the sector has competitive elements. Competition is not static. The dynamic process of rivalry and innovation that characterises a good competitive process cannot be replicated by a planned discussion between a company and its customers at a particular point in time. It is very difficult today to forecast innovation of the future and the process of discovery and trial and error that will lead to it. I am mindful of the quote often ascribed to Henry Ford: 'If I had listened too much to my customers at the start I would have invented a faster horse!'

VI – there is no playbook: experiment!

My final point is that we need to bear in mind that there is no standard model or blueprint for how regulators should design customer engagement processes, unlike for other aspects of price review, such as in calculating the Regulatory Asset Base or the cost of capital. So there is inevitably a process of regulators feeling their way on how best to conduct customer engagement. Each will need to experiment and learn. The price for enduring success in the long term is a tolerance of failure every now and then.

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Two models of consumer representation in utilities
A question of utility?

Sebastian Eyre

Introduction

The development of consumer representation in utilities has followed two broad models. One can be characterised as a 'bottom-up' complaint-handling model, the other as a 'top-down' think tank model. The most recent incarnation of organised consumer representation reflects a convergence of these two approaches.

At the same time, from the viewpoint of the regulated industry, the market challenges faced by rising input costs are changing. The new cost drivers are of a regulatory nature. Whereas in the past, price controls placed a considerable downward pressure on supplier costs, nowadays regulatory tools are being deployed to meet policy objectives that impose considerable investment requirements on the industry (such as smart meters, replacement expenditure, new investment). From an industry perspective, it has also become increasingly apparent that previously neglected arms of technical regulation have become more important for the representation of consumers in utilities. In this new world, the authority over what is claimed to be in the interest of consumers may well fragment as redistribution tensions between different groups of consumers become more apparent than they have been in the past.

Complaint driven model 1948–2008

Consumer representation in the UK emerged in the nationalisation of the energy sector in 1948. For example, this period saw the establishment of the Gas Consumer Council. This period was characterised by an emphasis on the resolution of consumer complaints and the provision of consumer advice. The rationale of 'controlling monopolies', a key concept in competition regulation at the time, lay behind this choice of model (see Guenault and Jackson 1960).

As a consequence, the successful resolution of complaints was central to the consumer representation organisation. This was seen as reflecting the actual preferences of consumers at that particular time. Consumers were able to seek redress if the monopoly was found to have breached well defined public service commitments, such as billing errors, poor connections and poor customer service. These organisations showed little interest in undertaking policy functions. Questions of general policy were left to the elected government of the day, which was, after all, the owner of the industry.

When privatisation occurred in the 1980s (in gas and electricity), the complaint-driven organisational model was transferred into free-standing non-departmental public bodies, funded by licence fees (in the same way as regulators). This transfer led to a change regarding the type of consumer that these organisations should focus on. The list included the chronically sick, those of pensionable age and those living in rural areas (e.g. Gas Act 1986, Utilities Act 2000). In this age of privatisation, these consumer organisations may have appeared dated, but they were able to offer distinct advice and complaint-resolution functions. They also undertook a growing amount of policy functions as these organisations directly engaged in dealing with complaints and advice rather than performing the mainly audit role that had characterised the function of their predecessors in the age of nationalised industries.

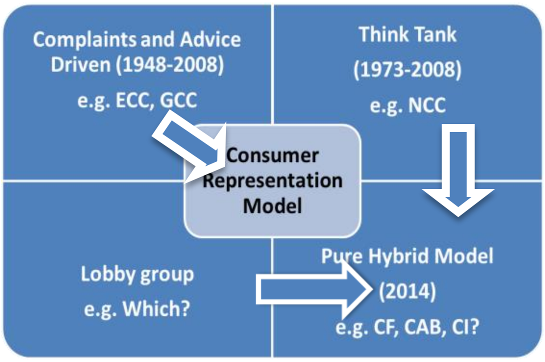
The think tank/ advisory model

The National Consumer Council (NCC) was established in 1975 by the Labour Government. It was to act as a consumer advocate and cover issues across the whole economy. As an organisation it contributed to government policy through reports and lobbying activity. The nature of consumer representation at this level meant that regulation was only one issue amongst many. Reports covered issues such as health (Age Concern/NCC) and the surveillance society (Lace 2005).

Convergence 2008–

After 2008 the trend has been to converge policy and complaint handling activities to produce a more explicitly hybrid approach to representation (Figure 1).

Figure 1 Models of consumer representation



How did these models work in practice?

In practice, both models of consumer representation have their strengths and weaknesses. The complaints-based approach that was deployed in utility regulation built on earlier guaranteed standards of performance and new issues resulting from the introduction of competition. The NCC was able to operate in the wider policy space of general consumer representation. Both groups co-operated with other interest groups over more specialist issues (e.g. Age Concern).

Table 1 Complaints vs policy models of consumer representation

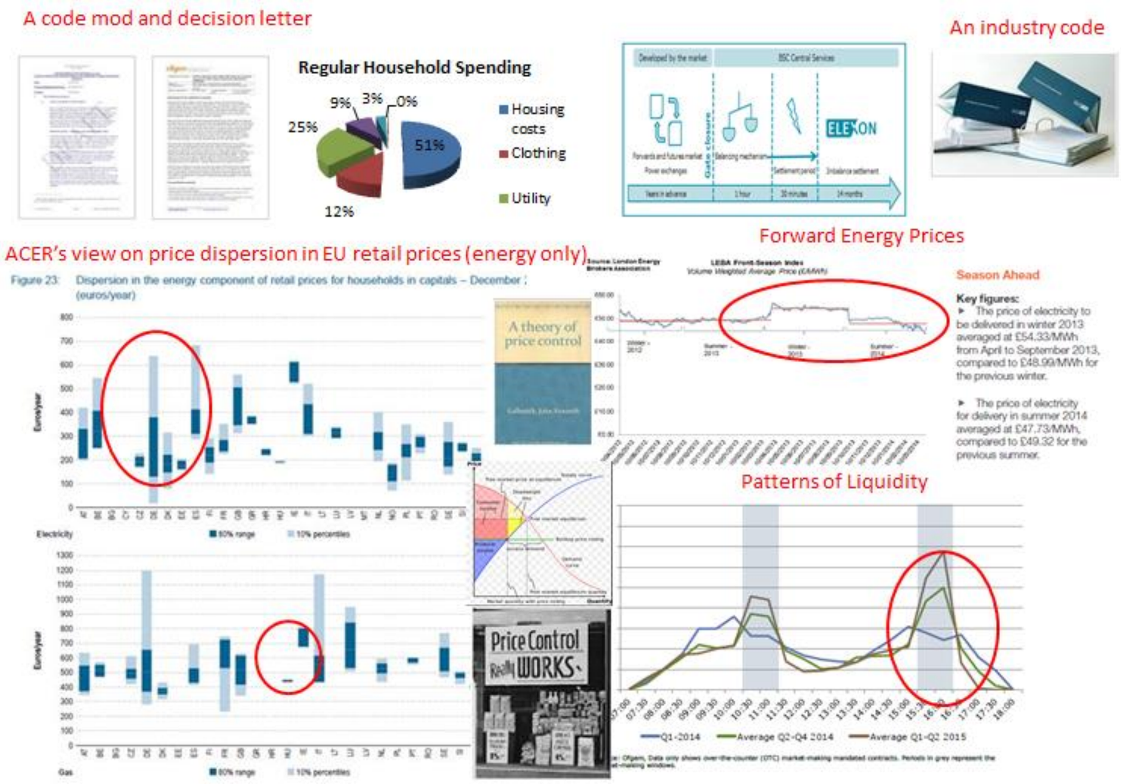
Criteria	Complaint driven model	Think tank model
Meta level argument	'We can help you ...'	'Policy must change ...'
Legitimacy	Is directly linked to customers experiences by what they do **not** want i.e. too many complaints.	Is defined by 'imaging a perfect world' or highlighting a new issue and offering a solution to it.
Core strategy	The core competence is to devise complaint categories and relationship with regulated/ nationalised activity (e.g. connections, meter reading, water pressure etc.); Generate new data.	Think tanks need a pipeline of well developed policy arguments. They also need to publicise them. They may use classical lobbying tools such as press releases, social media etc. They will on the whole only access new data by original research.
Skills	Likely to be in-house as that allows access to complaints data. The skills required are both technical and regulatory.	Likely to be more general and theoretical. Management decision is based on outsourcing vs commission research
Performance	Complaint handling metrics (volume, quality etc.); Help individual consumer and their **specific** problem	Citation, changes to primary legislation; Solve problems at root cause at a **general** level

Leading up to the 2000 Utilities Act, the proposal to establish a single independent consumer council was dramatically aborted during the second reading stage. Instead, the Utilities Act created 'energywatch' by merging gas and electricity councils. The late 2000s finally saw the creation of a single consumer body; Consumer Focus was created in 2008 as a result of a merger of Postwatch, energywatch, and the Welsh, Scottish and National consumer councils.

During this time, trust in upstream markets in energy collapsed in the light of price increases. Confidence in wholesale prices is highly relevant for wider consumer confidence in retail prices – and it is also related to switching. In many cases, suppliers therefore have only limited control over costs, e.g. network charges or taxes. As upstream markets therefore define downstream markets, they must be regarded as 'fair', especially as utilities account for 25 per cent of regular household spending and regulated charges for 50–100 per cent of the bill. The design of the quasi-market mechanisms across regulated industries (such as the balancing and settlement code in electricity, spectrum auctions in telecommunications) will typically incorporate consumer representation in one form or another, such as by providing for participation on an industry code, or by creating an advisory panel.

The contemporary crowding of the regulatory agenda for consumers poses considerable challenges for consumer groups as they have to address complaints about the underlying reasons for price increases. However, it is the regulatory system itself which through price control mechanisms has come to represent a major proportion of the bill. As an illustration of the considerable complexity of the agenda, November 2015 offers a good example. Consumer insights were sought, for example, on price dispersion in European markets, a liquidity report that indicated that liquidity levels were falling, and the debate over price controls and issues arising over a Competition and Markets Authority (CMA) investigation of energy (see Figure 2). In addition, there were numerous modifications that were being processed during this particular (and representative) month.

Figure 2 The regulatory agenda for November 2015



Two important questions have now emerged from the regulated industries perspective:

- Has a gap emerged in consumer representation between the existing organisational design and the requirements of recent developments in regulation?
- Are issues that have an impact on the consumers' final bill articulated as well as they could be?

Two key examples are (a) price controls and (b) regulated midstream prices. In both cases, it could be argued that consumer representation organisations accept many aspects of the regulatory frameworks that produce technical decisions which, in turn, can have considerable redistributional effects on different consumer groups. Whereas the 'common enemy' from 2008 onwards was the (high) level of input costs, regulation has now become a new significant cost driver. As regulation is being used to achieve specific and prescribed outcomes (such as sustainability or asset replacement) which increases costs, it is becoming harder for a consumer organisation to represent conflicting priorities. This wider trend also means that it is increasingly important to understand consumer preferences – as these can be linked to specific regulator designs such as trade-offs between containing price increases and imposing investment requirements. There has, in turn, been considerable overlap among research activities into consumer preferences among different consumer groups and the regulated industries (see Table 2). In the future, the resolution of disputes will therefore become increasingly about the evidence gathered by regulators as well as by consumer bodies and by regulated industries.

Table 2 Identifying consumer preferences: industry and consumer groups compared

Firms understand consumers in a number of different ways:	Consumer organisations understand consumer utility by:
Market research Lessons from marketing Customer service Complaints Enquiries	Conducting primary research Experience gained resolving complaints Trends Trends in complaints Enquiries

Conclusion

The current regulatory landscape implies that consumer organisations have to take into account:

- Technical regulatory issues in order to achieve success;
- Understanding consumer utility in terms of the menus offered by price controls and other regulatory processes;
- Being able to articulate their views in the process and exploit the opportunities given to them by regulators;
- Operating conditions of firms which are required to implement change.

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Customer engagement in the regulation of network industries

Cosmo Graham

The appropriate role for customers in a regulatory process depends on how that process is conceptualised. At one extreme, regulation can be thought of as a form of a political process which involves bargaining and negotiation between interested parties over the issues and that there is no one, correct answer. At the other end of the spectrum regulation can be seen as a technocratic process which requires specialised expertise and information that, when applied to the issues, can produce, at least in principle, correct answers to questions (Foster 1992). It may be that there is a lack of information or significant uncertainty about certain matters which means that, in practice, it is difficult to be certain that the answer(s) are correct, but that does not invalidate the effort. Regulation in the real world falls between these two extremes, but this is a useful starting point to think about how arrangements for consumer representation would differ, depending where on the spectrum the particular form of regulation at issue might be placed.

If regulation is conceived of as a political process then certain arrangements would be more common. There would be direct consumer representation within the agency, for example, at board level in a UK context. (For the purposes of this paper, I am using consumer and customer as synonyms.) The processes of decision making would take place much more in public forums and allow for greater challenge to the points of view of industry and regulators from consumer or customer representatives. Those who were representing the consumer would also have to be funded, perhaps through a levy on the bills. There would need to be bodies with a remit to represent the consumer interest which could be either statutory or voluntary. For example, there are a variety of consumer advocates at state level in the United States with statutory remits (see National Association of State Utility Consumer Advocates/NASUCA) as well as voluntary bodies (e.g. the Utility Reform Network, TURN).

Whilst the US may be a good example of a system where regulation is viewed as somewhat of a political process, in the UK, regulation has been seen largely as a technocratic exercise. Although there have been a variety of statutory consumer bodies existing over the years they have been bedevilled by uncertainty over their purpose and, in recent years, the thrust of government policy has been to wind them up, replace them with advisory committees and move their functions to Citizens Advice (BIS 2012). The last remaining specialist body is, of course, CC Water although there are consumer panels in communications and financial services. Policy making in the UK regulatory sector is not an adversarial but a consultative process. In the course of making policy the UK regulators generally act openly and produce a substantial amount of consultation documents and operate a variety of fora where they can obtain views. This is, however, consultation, not an opportunity for challenging the views of either the regulator or the other participants.

Looking to the future the regulatory agenda in a number of areas is becoming less technocratic, less about detailed issues of economic price regulation, despite being still critical in relation to water and energy distribution, and increasingly more about issues of sustainability and affordability, as well as consumer information and contract terms. More regulators in a variety of sectors are also now considering the issues of consumers in vulnerable circumstances, the first being Ofgem (2013). As these issues come more to the fore in the UK, there is clearly a role for consumers to play in developing policy in these areas. This in turn comes at a time of great challenge to a voluntary sector faced with major funding challenges and operating under severe time constraints. Local authorities are increasingly having to focus on their core remits, rather than devoting time to regulatory issues which might impact upon their communities. Significant responsibility has passed to Citizens Advice and it will take some time before it becomes apparent how well it will be able to undertake this mandate.

Regulatory policy is also beginning to be shaped away from the UK level. Decisions at European Union level are having an increasingly important effect on regulatory policy. Some issues may also migrate below the UK level. There are, for example, different fuel poverty strategies in all four parts of the UK and the provision of consumer advocacy and advice in Scotland will become a devolved matter under the Scotland Bill. The EU arrangements pose particular problems for consumer organisations to participate in the policy making process given the length of time it takes, the location (Brussels) and its opacity.

There are, therefore, both opportunities and challenges in relation to involving consumer in the regulatory process. A starting point is to ask what can we expect from consumer representatives? The problem is that many of them will not have a high level of technical expertise or access to independent sources of information. What they can offer is a form of independent challenge to positions and approaches taken by regulators and companies. In order to do this effectively they will need access to information, in a timely manner, and resources to help them analyse the information. In addition they are often well placed to identify issues that are occurring on the ground through, for example, complaints or complaints data. It is a truism that there is frequently a gap between the high level intentions of an organisation and the implementation of policy. Locally based consumer bodies are well placed to spot issues as they first arise, also ones that have national help lines.

There are a number of things that regulators can do to help promote consumer involvement. It is important for them to reach beyond the usual list of organisations with which they consult. For organisations that are new to the area, it could make sense for the regulator to give them a named contact. At the same time, it is also important that regulators design their processes taking into account the needs of consumer groups and the voluntary sector. For example, it would be worth asking voluntary organisations how they would like to be consulted. For some of them responding to a written consultation in the normal manner might be favoured, for others they might prefer workshops where the issues can be discussed and debated. Given the resource pressures that the voluntary sector is under it would make sense for the regulators to identify common issues on which they could consult, rather than a series of individual consultations.

The climate within the UK does seem to be moving more in favour of greater consumer engagement with the development of regulatory policy. For this to be effective, not only do the regulators need to be clear about the role that is to be played by consumer representatives, but they will also need to offer them significant support, particularly for the voluntary sector. Otherwise, the regulator may end up depending on individual consumer advocates with sufficient resources and interest in the process to act as proxies for all consumers. This may work in relation to certain sectors or issues but consumers are not homogenous and cannot be seen as all having the same interests (see Locke 1998). Consumer advocates therefore also need ways of ensuring that they are themselves in touch with issues affecting consumers in a variety of circumstances and also that they operate transparently and accountably.

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