



**Consumer
Focus**
Campaigning for a fair deal

Consumer Focus response to the review of Ofwat – A call for evidence

October 2010

The review of Ofwat – A call for evidence

We are pleased to respond to Defra's call for evidence in its review of Ofwat.

Consumer Focus has particular expertise on regulation in a number of sectors, most notably energy and post where we have a specific statutory remit, but we have also been active in the wider debate about regulation, developing expertise on regulatory structures, cultures and methods and applying these in our work across the economy.

Last year we published an analysis of six key regulators, including Ofwat, in our report *Rating Regulators*.¹ Our assessment framework consisted of 20 indicators which together form the essential building blocks of a consumer-focused regulator. These principles have informed much of our analysis in this submission:

Legal framework

- statutory objectives and duties enable the regulator to adequately promote the interests of all consumers
- responsibilities between different actors are clearly defined, without gaps or overlaps
- structures are sensitive to devolved contexts
- the right tools for the job

Culture and accountability

- translates statutory objectives into consumer-focused priorities and values
- embeds a consumer focus across all levels of the organisation
- transparent about its activities
- accessible to the general public, including disabled users
- works effectively in a devolved setting

State of readiness

- identifies likely sources of consumer detriment, both now and in the future, which shapes work priorities
- uses effective mechanisms to understand the consumer perspective and translate this insight into sound decisions
- works effectively with others, including with consumer organisations
- influences the wider regulatory agenda

State of action

- empowers consumers to help achieve regulatory outcomes
- has effective incentives to encourage compliance with its rules

¹ Consumer Focus (Feb 2009) *Rating regulators* <http://bit.ly/azgX7P>

- chooses the appropriate regulatory approach in the circumstances, and intervenes in a timely fashion when needed
- gives priority to, and intervenes effectively on behalf of, consumers who are vulnerable
- uses enforcement tools when appropriate to protect consumers

Impact and learning

- defines and measures its impact on consumers in terms of outcomes
- evaluates its work and embeds learning

Our overall view is that there is scope for improvements in the manner in which the water industry is regulated, with aspects of Ofwat's approach now looking somewhat outdated in comparison even with other utility regulators. We also share Water UK's view that there needs to be enhanced consumer advocacy in this sector, with deep skills in regulatory issues and the ability to learn lessons across sectors. We consider that the scale of consumer bodies, the nature of the issues and the expertise required together mean that this is likely to be most effectively delivered through a single cross-economy organisation.

1. Statutory framework and decision-making

Ofwat's application of its statutory duties and reflection of government guidance in its decision-making

How far are Ofwat's decisions leading to sustainable outcomes?

Delivery of the primary duties

Ofwat's primary duties are to protect the interests of consumers (where appropriate through promoting competition) and ensure water and sewerage companies are able to finance their businesses. Its secondary duties include contributing to sustainable development, having regard to the better regulation agenda and ensuring there is no undue discrimination between classes of customer.

We believe there has been a mixed picture in Ofwat's delivery of its primary duties. There have been some significant successes in terms of agreeing programmes and financing investments to improve drinking water quality and the river and coastal environment.

Efforts to promote competition (through concurrent powers with the Office of Fair Trading (OFT) under the Competition Act 1998) and examination of whether the water market is working effectively (through the Enterprise Act) have been muted. As the National Audit Office (NAO) noted in its recent report², Ofwat has only ever issued two 'decisions' under CA98 and both were for non-infringement. When consumers and potential new entrants have complained under CA98, Ofwat has used its regulatory powers or issued industry guidance (for instance on 'access charges' to allow new entrants to utilise monopoly assets). This reluctance to arrive at infringement decisions (and utilise the CA98 ability to fine businesses) might be interpreted by some businesses as a sign that anti-competitive practices will not be tackled.

² NAO (March 2010) *Review of the UK's Competition Landscape* <http://bit.ly/bRo0K4>

There is a debate about whether sector regulators should have concurrent powers with OFT on CA98 and Enterprise Act. We have some sympathy for the view that it needs a critical mass of legal and economic expertise in competition issues to make proper use of the powers. Without the critical mass there might be a tendency to use sector powers instead. There is a counter argument that sector regulators have superior or swifter powers under industry regulation/licensing – we do not find that wholly convincing.

Handling trade-offs

This multiplicity of objectives leads to tensions between its primary duties and its delivery of sustainable development goals. For example, how much should the present generation pay for modelled water scarcity issues 25 years from now?

In 2008 Ministers issued a social and environmental guidance. These required Ofwat to evaluate greenhouse gas emissions and finance water companies' 25-year water resource plans. It also required Ofwat to consider the impact of companies' charging policies – not just the aggregate amount of revenue collected through regulated activities but also the incidence on metered and unmetered customers, and within metered the impact of fixed charges and variable charges.

The Government's guidance was intended to help Ofwat analyse tensions between duties. It is not always clear this has been successful. Stringent wastewater and drinking water standards increase the use of energy in water treatment works. But because many of the regulations are expressed at particular abstraction and outflow points the regulations permit little flexibility for regulators to balance pressures to a water environment over the catchment as a whole.

We believe that decisions on trade-offs between different public policy outcomes to be essentially political ones and should be taken by ministers to ensure democratic accountability. Ofwat has interpreted its secondary duty about 'no undue preference' as meaning charges should not be set to explicitly allows transfers between different groups of customers. (Though there are implicit transfers since urban and rural water tariffs are the same despite differences in the cost to serve.) Decisions about equity and social justice are essentially value-laden judgements that should reflect the wishes of the public as expressed through the democratic process.

We think one such way is through the construction of a clear upfront mandate for regulation. We explored how such a mandate might work in our publication *Regulating in the consumer interest*.³ Clarity over roles must start with parliament ensuring that the regulator has a clear statutory basis. This should include straightforward regulatory objectives to ensure it has a sense of purpose. Protecting consumers must take priority over objectives such as promoting competition, which is a means rather than an end.

This could mean every government department publishing a strategic policy document for each regulated area within its remit. This document could spell out the Government's visions and objectives for the sector in the forthcoming parliamentary term: what it intends to do to give effect to that vision; what it expects the regulator to do; and how it intends to ensure co-ordination of these two parallel streams of work.

There should also be clarity as to how the day-to-day relationship between departments and regulators operates in practice. This might take the form of a 'regulatory contract' between government and the regulator, outlining who is doing what and what resources each will have to ensure that this work is done as efficiently and effectively as possible. Each of these documents should be in the public domain.

³ March 2010, <http://bit.ly/dwBGRS> (PDF 330KB)

Select committees could question representatives from each actor to assure themselves that the work is allocated and co-ordinated appropriately.

Will future challenges require changes to the way Ofwat operates?

Government is putting a greater focus on climate adaptation and we would expect this to include incentives to conserve water for households and business. A number of water resource zones are already under stress especially in the southeast. Areas in the southwest and Yorkshire and Humber are under significant and growing flood risk.

In the energy sector there is a long tradition of governments setting energy efficiency targets (EESOP, EEC1, EEC2 and CERT/CESP) which the regulator Ofgem (previously Ofgas and OFFER) have administered. These ask energy suppliers to implement measures to reduce energy consumption. We think these are a useful way of addressing water efficiency and water affordability issues.

There might be a degree of geographic targeting of these regulations – not all water regions are under the same water stress. Not all catchments face the same risks of surface water flooding. We understand that around London the Thames Water Resource plan requires households to cut water use by 25 per cent over the next 20 years to just 130 litre per day.

There are lessons to be learnt from regulators in other countries. In California energy efficiency is formalised so the doctrine adopted by the regulator is ‘energy efficiency as the resource of first choice.’ This makes good economic sense in terms of net present value, but not necessarily good business sense because of the way regulated companies only earn a return on their own capital investment, not investment in their customers’ homes. In Vermont the energy efficiency utility Efficiency Vermont operates geographic targeting of its energy conservation programme as a least cost means of addressing bottlenecks in the networks capacity.⁴

It is important for regulators (as a community) to engage in the roll-out of smart metering technology. In the energy sector communications infrastructure is being deployed that will allow companies to remotely obtain consumption data. BT and the major mobile network operators have all been looking at how to get involved with the deployment of smart meters on the connectivity side. BT is working in partnership with Arqiva (a broadcasting company) and Detica (a branch of BAE Systems) with the aim of building and operating a nationwide smart meter communications network. Vodafone has already signed a multi-million pound contract to assist with British Gas’s deployment of smart meters. Ofcom and Ofgem are working with Government to ensure there are suitable interoperability standards. This is an important opportunity for Ofwat and the water industry to engage with the Walker agenda of implementing water metering. It provides an opportunity to reduce the costs of introducing cost-reflective water charges for consumers.

There is considerable scope for Ofwat and Ofgem (especially its e-serve function) to work together to reduce the use of hot water. The heating of water accounts for around a quarter of gas use in a home. Actions to reduce hot water consumption will benefit consumers. These might be achieved through the Green Deal and Energy Company Obligation, which we hope will provide customers with unified information to reduce their water and energy bills. (Though we would oppose failure to pay for cold water measures being collected through their energy bill, or for water debts to adversely affect customers’ relationship with their energy supplier.)

⁴ <http://bit.ly/ap46is>

What are the risks to changing Ofwat's duties and the respective roles of Government and independent regulator?

As noted above, we favour a strategic role for government, setting the direction of travel and desired outcomes, with the regulator responsible for implementation. Too often in the past, government has sent unclear or conflicting signals about its aims, with confusion about responsibilities especially where there is more than one regulator active within a sector. Different pieces of legislation with different objectives can add to the confusion. All of this can create uncertainty and lead to regulators second-guessing what government wants. Importantly, it also makes it harder to hold regulators accountable for their performance.

It is of course unrealistic to expect a perfect division of responsibilities because in practice much of the benefit and cost (in all senses, social and environmental as well as financial) of any given policy is derived from how it is implemented. But there is scope for much more clarity than exists now, with more of a sense of strategy, collaboration and complementary skills and purpose.

In the case of household water and wastewater, along with flood risk management, the relatively high number of independent reviews in recent years has introduced an important degree of external perspective and input but inevitably raises questions about government's ability or desire to determine strategy itself and/or its confidence in Ofwat to manage its own development in a changing landscape.

2. Sustainable development

How far are Ofwat's decisions leading to sustainable outcomes?

We refer you to our answers at question 1.

Ofwat has appeared sometimes to interpret its role of protecting the interests of customers as a duty to reduce customer bills. For instance Ofwat has tended to adopt a sceptical approach to the need for new investment, for example sometimes bringing it into disagreement with the Environment Agency on the need to build new reservoirs. Areas in the southeast are under significant water stress already and there is forecast to be a 25 per cent under provision of water in the Thames service area by 2025.

Some tension is almost unavoidable and may potentially even be healthy on occasion, but it is not at all clear that consumers' long-term interests play any part in the resolution of such stand-offs.

Since the flooding in summer 2006 and the subsequent review by Sir Michael Pitt there has been greater emphasis on investment in surface water drainage. We regard this as a high priority since the failure to safeguard properties from flood risk has adverse impacts on consumers and has knock-on effects on the home insurance market too. We expect there to be increased pressures for investment to respond to UK-CIP and the Committee on Climate Change's adaptation committee recommendations.

3. Relations with other regulators and water and sewerage companies

Experience of dealing with Ofwat, and of the way Ofwat works with other regulators.

We do not provide consumer views in water and wastewater price determinations so cannot comment on how detailed working relationships function in practice. We have some experience of working with Ofwat, the Consumer Council for Water (CCWater) and the Environment Agency on broader issues.

We think there are some inevitable tensions that arise from the design of the regulatory system through separating out environmental, drinking water quality and the economic regulation. The current pattern of incentives on the Environment Agency and Drinking Water Inspectorate (DWI), water companies and Ofwat encourages such divergent views. Ofwat regards calls for new spending sceptically, while shareholders in water companies see advantage in higher approved capital spend. Sometimes the Environment Agency and DWI will agree with water companies' capital schemes since they have an interest in agreeing credible water resource plans, hitting aquatic biodiversity targets or reducing risk of non-compliance with a drinking water quality standard. There is a well-known bias for regulated monopolies to request for more capital to expand their regulated asset base. Improvements in processes to reduce operating costs do not give rise to the same enduring increase in profits that allowed capital expenditures do. There is no correct technical answer to these stand-offs, and nor is the existence of such tensions new.

We believe it is essential that customer views and preferences are fully integrated too. Consumer views on priorities and the trade-offs between sewer flooding, access to water for recreation, taste and odour of drinking water, smell and nuisance from sewage treatment works should be significant in reaching decisions about the planned investment programme.

Gauging reliable information on preferences and trade-offs is challenging. Consumer Focus is just completing some research, in conjunction with Postcomm, using choice-based 'conjoint' techniques on the different services provided by Royal Mail as part of the universal service obligation. If costs need to be cut, it is important to be able to discriminate between needs and wants. This research allows consumers to express trade-offs between their needs and wants to give the regulators some idea of their preferences.

We believe the present metrics used by Ofwat are too procedural; this view is echoed by the industry (see for instance Severn Trent's thoughtful report *Changing course*). Ofwat sets performance targets in terms of measurable metrics: how quickly the phone is answered or how quickly a letter is handled, instead of the quality of the response. The style of regulation seems out of line with what now happens in other sectors and may constrain innovation. It is not clear whether the nature and detail of these measures springs from any insight into consumer expectations; do consumers really want a response within 10 days, or at least do they consider this more important than other aspects of service? The danger is that prescriptive rules like this encourage micro-management by the regulator and a culture of compliance rather than innovation. We believe more use should be made of outcomes-based measures of customer service. Matters like sewer flooding cause real distress and should be given significant weight in assessing performance. Reputational indicators of consumer perceptions should also be used.

4. Protecting, serving and representing customers

The effectiveness of the current arrangements involving Ofwat and the Consumer Council for Water.

On 14 October Government announced its plans to transfer consumer advocacy functions of Consumer Focus (and other sector consumer bodies subject to reviews) to Citizens Advice by April 2012. It has been our view that there should be further consolidation of the freestanding consumer bodies. The existence of multiple bodies inevitably means some inefficiency and reduced effectiveness, and there would be value in changing things – although experience tells us to be cautious about the immediate opportunities for major cost savings as a result of structural change.

We think there is a case for a single GB consumer organisation, bringing together the main bodies speaking for consumers across the economy and in key markets: Consumer Focus, CCWater, Passenger Focus and the Air Transport Users Council. This would have expertise in particular sectors but also the ability to deal with cross-cutting issues. It would reflect the devolved nature of the GB nations and be able to operate at local, national and international level.

Alongside the establishment of a single organisation responsible for advocating the consumer interest in key sectors, we would suggest a more targeted and joined-up approach to advice and complaints, with front-line contact through Consumer Direct/Citizens Advice and specialist advice agencies, specialist casework support for vulnerable consumers, greater emphasis on companies taking responsibility for their own complaint handling systems, and an ombudsman within each sector. This is the approach adopted since 2008 in the energy and postal sectors, and while there have been teething problems at times the model has proved robust.

We estimate that this approach would save over £6 million and deliver both a better consumer service, improved company performance and more effective advocacy. In short this model is both more effective and cheaper.

It is for Government to determine what arrangements it considers most appropriate for consumer protection and the promotion of consumers' interests in different sectors; clearly the present review may well have a significant influence on aspects of this. Our view is that whatever institutional arrangements are adopted, it is important to have a strong and expert consumer voice in regulated markets where competition alone will not deliver the right consumer outcomes – this includes not only water but also energy, postal services, rail, air transport and aspects of the communications sector.

Present sectoral regulation is, for example, too often framed around a shared-industry perspective. Industry and regulator may have different answers, but they often have a shared view on the question. Arguably things would be different in the water and wastewater sector if there had been a powerful outside voice asking some different questions. What outcomes do water customers really value? What scope is there for synergies across water, energy and telecoms for instance in meter reading?

We share the view of industry bodies such as Water UK that a regulator is not, and should not be, a consumer champion, and there is a need for consumer organisations to be quite separate from regulators and able to act as a balance to the influence of regulated businesses. It is unclear in the current proposals for changes in the consumer landscape where expertise in regulated sectors will sit and the extent to which it will be joined-up on a cross-sectoral basis. We consider that there remains a need and an opportunity for improvements here.

CCWater has performed a valuable role in helping promote consumer interests in the water and wastewater market. But there are inevitably challenges for a single sectoral consumer body to acquire and maintain the wide range of skills needed, and to be able to build strong relationships within the sector while having the ability to step back and draw on experiences elsewhere. This latter ability is often one of the greatest strengths of consumer bodies, giving them a perspective that focuses on consumers rather than industries and allowing them to compare and contrast businesses (and indeed regulators) and promote best practice.

Our own view is that Consumer Focus has demonstrated over the past two years that it is possible to deliver simultaneously on a sector-specific remit and a wider cross-economy role. There are numerous common issues affecting the regulated network utilities of energy, post, water and rail, as well as aspects of the communications sector, and they require similar consumer policy skills, and an appreciation of network economics. Over the last 12 months Consumer Focus has engaged with many complex and economically nuanced debates on the economic regulation of networks. These have included:

- The lack of liquidity in GB gas and electricity markets, especially on long dated forward contracts inhibiting new entrants entering electricity supply (this will be an issue in water markets if Cave's review is implemented)
- The increase in the margin in wholesale and retail power and gas prices between July 2009 and spring 2010 as fossil fuel commodity prices fell. Our papers on this subject have been widely quoted and we believe influenced Ofgem to adopt a more critical approach to in its analysis of retail margins
- Publication of a new thinking paper: *A new energy infrastructure* which sought to unite thinking about energy efficiency, new networks (including district heating) and local democratic governance which fed into Ofgem thinking on RPI-X@20 and also DECC/CLG thinking about Green Deal and local government's role in decarbonisation and fuel poverty
- Driving out practical improvements from Ofgem's 2008 energy probe including stronger mis-selling regulations, annual energy statements and easing the debt-blocking arrangements that prevented consumers taking advantage of the best deals. Our work with Ofgem has also markedly improved standards of debt and disconnection procedures
- Our advocacy helping to gain an increase in Warm Front funding for consumers in fuel poverty and let to millions of consumers getting cheaper energy prices by benefiting from some £150 million of mandatory social tariffs

One of the core strengths of Consumer Focus, recognised by industry and stakeholders alike, is the ability to transfer lessons from one sector to another. Table 1 shows the numbers of complaints received by Consumer Direct against firms operating in the water, energy and communications markets. Improving the consumer experience means learning lessons from one sector and applying them in others.

Table 1: Complaints received by Consumer Direct between 1/9/09 to 31/8/10

Product	Against all traders	50 largest traders
Mobile phone services	19791	14336
Fixed line phone	13773	9229
Gas	2138	1272
Water	1119	625
Dual fuel	985	643
Sewerage	136	77

There are features in the water and wastewater market that other utilities might learn from. There are important differences between the water and sewerage market and the energy and telecoms markets that give rise to the low level of complaints. The absence of retail competition means less detriment is caused through mis-selling, especially doorstep selling. The absence of widespread metering in water supply means there are fewer problems from disputed charges. These account for a high proportion of consumer complaints in the energy sector. Customers are also concerned about the fact that energy bills are much higher than water and sewerage charges and have risen quickly over recent years.

Depth and breadth of experience across consumer issues in marketing, doorstep selling, product complexity, tariff bundling, customer service performance, consumer information, periodic billing, complaint handling and redress provide the weight of argument and evidence that persuades markets and service providers to improve.

Water UK⁵ has said: ‘...the consumer body must be strong, representative, knowledgeable and probably local. It is questionable whether CCWater as currently constituted meets these all those criteria.’ This is no criticism of CCWater’s staff or council, but rather a matter of scope, resources and powers. We have for example found that our own power, under section 24 of the Consumers, Estate Agents and Redress Act 2007, which allows us to get information from companies, has proved an invaluable tool in our armoury.

In Scotland the functions of Waterwatch Scotland will be rolled into Consumer Focus Scotland next summer. The evidence to date is that this merger is already bringing value. Consumer Focus Scotland is working with the Water Industry Commission (the Scottish water regulator) and is beginning to investigate the constructive engagement model in the light of the Civil Aviation Authority (CAA) model. We hosted a roundtable event in the Consumer Focus Scotland office in September to facilitate the Commission’s wish to consult on best practice in consumer engagement.

Vulnerable consumers

Ofwat does not have a duty to protect the interests of vulnerable consumers. We think this is matter that ministers should reconsider. In practice the best water companies do make special provisions for blind and deaf customers to allow them to read their bills/communicate over the phone. Customers with special medical needs (e.g. need continual access to water for dialysis machines) are also catered for.

Consumer Focus has done a significant amount of work on fuel poverty and it is clear there are strong connections with issues on water poverty, though it does not appear that these links are being fully made.

Ofwat has been hesitant about developing policies to address water poverty. It is already an issue for a minority of households. Water bills are 3 per cent or more of the disposable incomes of around 11 per cent of customers. Greater water scarcity and metering mean that in parts of the country water affordability will become an increasingly important issue.

⁵ Water UK (June 2010) *Meeting Future Challenges – a blueprint for future action*

5. Value for money

Ofwat's approach in comparison to other regulators both in England and Wales, and in other countries.

Sharing of information across economic regulators

The analysis we undertook for our publication *Rating regulators* suggested that 'where good practice occurs in one regulator, it is rare to find similar working methods elsewhere.'⁶

Quote from Consumer Focus's *Rating regulators: Ofwat*

Page 8: Ofwat's sanctioning toolkit is largely fit for purpose following the Water Act 2003; however, it is surprising that Ofwat fell outside of the Regulatory Enforcement and Sanctions Act, which provides regulators with powers to order companies to compensate customers

Page 6: In particular, there appears to be a lack of consensus and clarity – about the proper role of Ofwat with respect to water affordability issues. Ofwat told us it does not set prices on the basis of affordability but has a vital role in ensuring that prices are kept as low as possible consistent with allowing an efficient company to carry out its functions – thus ensuring that the concept of prices being as affordable as possible to all customers.

This was echoed in the House of Lords Select Committee on Economic Regulators that concluded action is necessary to improve regulators' joint working.

Ofwat is attempting to learn from other economic regulators. Senior staff from the Office of Rail Regulation (ORR), Ofgem and Ofcom sit on Ofwat's Advisory Panel, as does Consumer Focus. This is welcome. Regulators have tended to work within their own industry silos, discounting experience within other sectors as irrelevant. There are opportunities for customers to benefit from greater joint working between utilities and the regulatory framework does not always makes this easy (for instance the five-year price setting periods are all out of synch). The roll-out of smart meters would be a sensible time to roll-out water metering and share communications channels to reduce the costs of meter reading across water, gas and electricity.

All the economic regulators face similar challenges in setting the price for network monopolies. But it is often unclear why they reach different conclusions. For instance:

- How should you take account of changes in deficits of regulated companies' pension liabilities? (Ofwat allows only some of the costs to be passed through to bills, Ofgem allows the entire cost to be passed through)
- What is the assumed gearing between equity and debt used to calculate the weighted average cost of capital?
- Is the current system of financing sustainable – especially if interest rates rise? (The water industry now has £33 billion of debt finance and 72 per cent gearing)
- What is the assumed risk-free rate of interest? (Ofwat was criticised by industry – as one might expect – for setting the real rate of return too low)

⁶ <http://bit.ly/8XEyPw> (PDF 1.6MB)

- How frequently should network pricing be reviewed (at present all the economic regulators review prices every five years, Ofgem is proposing to make the duration of price control longer)
- How should regulators assess whether companies need to spend money on new infrastructure? (Ofwat uses consultant civil engineers known as ‘reporters’ paid for by consumers to go through company plans)

We don’t know which regulator has the correct approach to these issues but it surprises us there is not more sharing of expertise between regulators. The different regulators do develop quite different and innovative approaches to common problems. For instance Ofwat’s introduction of menu regulation in PR09 addressed the perennial issue that faces regulators of trying to incentivise companies to make accurate assessments of the cost of new investment. If this has worked should it be adopted by all the economic regulators?

We note that in the United States it is quite common for states to have a single body to regulate across several network industries allowing the sharing of expertise. For instance the California Public Utilities Commission regulates investor-owned companies in water, energy, transportation and communications. (Bearing in mind there is also a thriving set of publicly owned utilities in the state and also co-operatively owned distribution companies). We are not arguing for a substantial consolidation of economic regulators since this would bring about upheaval and institutional disruption for some time. But the question about how regulators can learn from one another needs to be posed.

One problem with all the regulatory regimes is their increased complexity. There is a genuine problem of accountability to customers when the process gives rise to so much paperwork and consultations. One water company CEO recently commented his company had submitted 1600 pages of documents, analysis and justification to Ofwat’s PR09 process. This level of overly detailed regulation of plans is not conducive to innovation nor effective scrutiny by stakeholders, something we know that Ofwat is keen to address in the next price round.

Engagement with customers learning from other sectors

We expect effective consumer engagement to be a standard, but key, part of the operations of all regulators who exist to protect and promote consumers’ interests. The approach being taken within the water and wastewater sector is laid out well in Ofwat’s document *Involving customers in the price setting process – a discussion paper*⁷. This sets out the approach taken in PR09 and previous price reviews and looks at the approach taken in other sectors, and poses the question whether customers should take the lead, drawing analogy with CAA’s constructive engagement.

We think they should. Benefits of engagement include greater legitimacy for the regulator; increased ability to take tough decisions; better awareness of the likely impact of regulatory actions on different groups of consumers; and more efficient use of resources as these are targeted on the right issues.

Engagement needs to provide real opportunities for consumers to contribute to the work of Ofwat. Its engagement strategy should provide:

- Opportunities to engage in Ofwat’s corporate planning processes to allow consumers to help shape priorities
- A ‘consumer radar’ of emerging issues and areas of detriment

⁷ http://www.ofwat.gov.uk/future/monopolies/fpl/prs_inf_1010fplcust.pdf

- The ability to work both with representative bodies and directly with consumers themselves

In order to be accountable to the public the regulator needs to be accessible to the public and provide information in a timely and comprehensible way for a range of audiences, not just for the industry.

There has been significant change in this area over the last few years. The Food Standards Agency has long set an example for others, through its use of citizen juries and consumer panels; but others such as Ofcom and increasingly Ofgem have picked up the pace and are innovating in this area, both in terms of direct work with consumers and use of expert consumer panels, for example on price control reviews.

Ofwat says in its Forward Programme⁸ that *'In all areas, we will take account of consumers' views as part of our evidence-based approach to regulation and policy development.'* It has an expert panel (mentioned earlier), and it has a Business Customer Forum. But it is unclear whether it has coherent strategy for consumer engagement and the extent to which it has driven its agenda or individual pieces of work. CCWater's research with customers has clearly filled a gap to some extent, but there is little sense of a regulator whose work is underpinned by consumer engagement in the way that some others are.

In PR09 CCWater wrote to the water companies asking them to convene quadripartite meetings with the Environment Agency, DWI and CCWater in each service territory. These provided feedback to the water company at different stages of PR09.

We see merit in going much further than this, re-connecting with consumers through the 'constructive engagement' approach used by the Civil Aviation Authority. Rather than BAA and regulator agreeing which new capital expenditure was necessary, a much more prominent role was given to customers (in this instance airlines rather than passengers). These would include the volume and capacity requirements, the nature and level of service outputs, the nature and scale of the investment programme etc. CAA gave the parties to the constructive engagement general rules and the time by which they'd need a decision. CAA retained responsibility other parts of the price determination process (like proposing the weighted cost of capital and operational efficiency expectations). CAA's appraisal in 2007 was that the process went well.

Constructive engagement processes could clearly be relevant within the water sector and we welcome Ofwat's recent discussion paper on this. Some of the investment need – in improvements to sewers to reduce flood risk, odour and colour of water, reservoir capacity – is really about choices between competing preferences. Consumer Focus is just in the process of completing work to understand the trade-offs consumers would make between packages of services that Royal Mail is required to deliver under the universal service obligation⁹. These ideas could be used to better understand consumers' underlying preferences for the multiple services provided by new investment.

⁸ <http://bit.ly/d6aUiY> (PDF 744KB) page 7

⁹ Ofwat, *Involving customers in the price setting process- a discussion paper*, October 2010



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