

Regulated industries and consumers



Fresh thinking

About Consumer Focus

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland.

We operate across the whole of the economy, persuading businesses, public services and policy makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers and aims to give people a stronger voice.

We don't just draw attention to problems – we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

Preface



There has never been a greater need for the interests of consumers to be effectively represented. Vital and urgent plans to modernise the national infrastructure for energy, water, rail, communications and airports require some £200 billion of private sector investment by 2016 – the equivalent of building more than four Olympics every year¹. These costs will be passed, in whole or in part, to customers who face unprecedented increases in bills and charges.

The sectors concerned are all subject to economic regulation by independent regulators working within established statutory frameworks, some of which are currently under review. The need to secure infrastructure investment on such a massive scale poses both challenges and opportunities for more effective representation of consumer interests. The decisions taken over the next few years will have significant implications for consumers for a generation.

It is essential that the widest possible range of consumers – including people living in remote areas, poor inner city families, vulnerable elderly consumers, and micro businesses – are aware of the changes ahead and the reasons for them, and are effectively consulted and engaged on the issues. This lies at the heart of consumer empowerment. A key requirement for effective empowerment is that there are effective independent mechanisms for translating what the public says into the language of policy debates.

¹ The budget for the London 2012 Olympic and Paralympic Games, National Audit Office

Regulatory decisions will need to take full account of consumer interests and deliver outcomes that are seen to be fair if the desired shift in scale in industry funding is to be achieved. This is crucial for business and for economic growth, as well as for consumers.

This short paper by Consumer Focus, the UK's statutory consumer watchdog for energy and post and general consumer protection body, sets out the arguments in favour of strong consumer representation in sectors of the economy subject to economic regulation. It also makes the case for maximising synergies available from working across sectors. This would allow consumer representation in specific markets to benefit in full from best (and learn from worst) practices in other sectors and from understanding cross-sectoral issues such as consumer vulnerability, charging structures, and redress. A cross-sectoral approach would maximise the knowledge and skills needed to engage effectively with Government, the EU, industry, regulators and consumers.

We hope that the thoughts in this paper can contribute to current policy thinking on these issues across Government including the Department for Business, Innovation and Skills' (BIS) review of the Principles for Economic Regulation; BIS's reviews of the consumer and competition landscapes; the Department of Energy and Climate Change's (DECC) review of OFGEM; Department for Environment, Food & Rural Affairs' (DEFRA) review of OFWAT; and current Department for Transport (DfT) work on airports and rail regulation.

Consumer Focus is to be wound up in 2013 and our functions largely transferred to Citizens Advice, Citizens Advice Scotland and the General Consumer Council for Northern Ireland. This note is not about who undertakes the work or where it is done – which is a matter for Government and subject to forthcoming public consultation – but about getting the right resources, powers, skills, knowledge and processes in place to deal with the challenges consumers face over the coming years.

Christine Farnish
Chair, Consumer Focus

Executive summary



Sectors of the economy subject to economic regulation – energy, water, post and communications, rail transport and airports – demonstrate a number of common features. Generally speaking they:

- provide life-essential services, where lack of access can impact the ability of consumers to be economically active or function fully in society
- face major infrastructure investment challenges – £200 billion over the next five years – where substantial additional costs are to be passed to consumers
- comprise large and complex markets with equally complex regulatory systems, making it important for the concerns of ordinary consumers to be represented effectively in policy debates
- have arrangements for engaging consumers in decisions about costs and charges and other matters which vary from sector to sector and which could be more robust
- are markets where the benefits of competition – which normally delivers value and quality to consumers – are not fully felt, either because of network effects or economies of scale, and where consumers are often unable to exercise effective choice without comprehensive knowledge of the market

- demonstrate a range of common issues including access to essential services, allocation of costs, privacy and the use of customer data, structure of bills and charges, provision of consumer information, and the needs of vulnerable and low income consumers
- are markets where special efforts are needed to inform and engage consumers in order to promote informed choice and effective consumer representation

The Government recognises that these markets require ‘economic regulation’, with independent statutory regulators charged with balancing a range of public policy objectives to achieve economically desirable outcomes. The BIS call for evidence on *Principles for Economic Regulation*² states that ‘regulators’ duties should be concentrated on economic considerations including protecting the interests of current and future consumers’.

It is essential that there are effective mechanisms for ensuring that consumer interests can be adequately represented as we move into the next decade. The Government’s current and planned reviews of specific sectors, of economic regulation and of consumer representation more generally, provide opportunities to strengthen current arrangements and improve their legitimacy. This is particularly important in view of the need for countervailing consumer input to balance representations made by regulated firms.

² *Principles for economic regulation: a call for evidence*, BIS, January 2011

Empowering individuals and groups of consumers will be ever more important in the years to come, but this will not be enough to ensure that consumers are fully involved in major decisions. There also needs to be effective consumer engagement by regulators, for example through qualitative and deliberative research and the formal involvement of a consumer representative body in regulatory processes which can result in additional costs to consumers; and the ability of a consumer body to conduct policy work that is independent of regulators in terms of both the choice of topic and the analysis.

Representing consumer interests in these complex markets requires discrete skills and expertise including high level consumer policy and research, an understanding of behavioural economics, an ability to understand complex technical issues, an understanding of how markets work and regulatory trade-offs, and consumer information and engagement expertise.

Any organisation charged with representing consumer interests in these markets needs appropriate statutory powers, including powers to request information from regulated businesses and to formally engage in regulatory processes such as changes to licence conditions or price reviews.

A number of consumer issues are common across the sectors concerned:

- access in remote rural areas
- affordability, particularly for vulnerable consumers
- complexity of tariffs and charges
- affordability and access for small business consumers

- privacy and the use of customer data
- customer service standards and redress when things go wrong
- clarity and comprehensibility of customer information
- switching and choice
- the fair allocation of costs and charges to different customer segments

There are strong synergies and efficiencies to be exploited by coralling consumer representation functions together.

In addition, all the regulated markets are subject to EU legislation where effective consumer policy input to the European Commission, European Parliament and European consumer bodies is essential to ensuring the right balance is struck in EU regulatory frameworks. Highly specialist skills are needed to provide such input, and competence in this area is a scarce resource.

There is a real need across all regulated sectors to build consumer awareness of, and confidence in, the changes that lie ahead. This is particularly important at a time when consumers will be subject to multiple impacts in terms of increased charges and further technological change.

There are therefore strong public policy grounds to bring consumer representation arrangements in economically regulated sectors together, to exploit synergies and common issues and to ensure that an efficient and effective voice for consumers is available over the coming decade. It should be possible to realise these benefits in ways that do not reduce sector-specific expertise or incur transition risk provided all parties involved work constructively together to create a strong system of consumer representation for the future.

Introduction



The UK's energy, water, passenger transport and communications (including post) markets share a number of features in common:

- All provide services that are essential for citizens to function in society and in the wider economy, raising important issues of access and affordability. Often it is the same households and individuals who are affected – people who struggle to afford to heat their home may equally have difficulties paying for water
- All demonstrate complexities in both product and service offering and in pricing models, making it difficult for consumers to make informed choices and exercise market power
- All are relatively heavily regulated in whole or in part because it is not possible, for various reasons, for normal competitive markets to function properly across all of the sectors in question
- All have broadly similar regulatory structures, using fairly similar toolkits and statutory frameworks

The consumer issues in these sectors often show close parallels. These include the treatment of vulnerability and disadvantage, privacy and the use of customer data, redress, access and charging terms for SMEs, the interests of rural consumers, the effect of the digital revolution on both company and consumer behaviour, the promotion of sustainable consumption, cost reflectivity in charging structures, switching, and what constitutes effective competition and choice.

Investment needs



All these sectors face significant investment needs over the next few years. The immediate decades after privatisation saw major efficiency gains which enabled consumer bills to stay flat or be reduced. We are now entering a new phase, with significant levels of private investment needed and significant new costs being passed to consumers and/or taxpayers with the former likely to bear the lion's share.

The Government plans for UK infrastructure investment to be £200 billion³ over the next five years across these sectors:

- Ofgem forecasts that the **energy** industry will need to invest up to £200 billion in the next decade⁴
- **Water** UK says the industry in England and Wales will invest £22 billion over the next five years⁵
- The Government is to provide £14 billion to Network **Rail** for capital maintenance and infrastructure investment, with a further £750 million for high speed rail⁶. Network Rail says £1 billion will be invested over the next three years by third parties on enhancements to the network⁷
- BAA plans to invest £4.3 billion at Heathrow **airport** between 2008 and 2013⁸. The owners of Gatwick plan to invest over £1 billion in the same period⁹

³ The Government's National Infrastructure Plan 2010 (HM Treasury October 2010) p3 <http://bit.ly/gAh760>

⁴ <http://bit.ly/h3l8Y6>

⁵ <http://bit.ly/fkBDMc>

⁶ <http://bit.ly/eAHj1l>

⁷ <http://bit.ly/fiEzAq>

⁸ <http://bit.ly/eQcV8l>

⁹ <http://bit.ly/eTNEwL>

- Royal **Mail** is investing £2.1 billion in modernising its business¹⁰
- The Government recently announced a £1.3 billion package to modernise the **post office** network over the next four years
- Auctions in 2012 for communications spectrum are likely to result in significant expenditure to enable next generation **mobile** services¹¹
- The Government plans to invest £530 million to increase access to **broadband** over and above substantial investment plans by the communications sector in areas not subject to economic regulation¹²

There are major issues to be decided about the relative extent to which taxpayers, shareholders and consumers foot the bill for all this investment, and – where consumers do pay – what the right balance is between current and future consumers and between residential and business users.

Equally there are issues to be decided about who benefits from this investment, for example, the balance between users and the wider public interest (eg in energy security, sustainability, the viability of remote communities); smaller and larger commercial users; consumers and employees; disadvantaged consumers and the mass market.

A failure to involve consumers in the major decisions affecting them threatens the legitimacy of both industry and regulators and risks creating greater uncertainty for investors as a result of potential backlash from consumers and political risk.

¹⁰ <http://bit.ly/g1lIQt>

¹¹ <http://bit.ly/bMN493>

¹² <http://bit.ly/9AWLwT>

Regulatory decision-making



The Government has acknowledged that existing regulatory regimes may not be up to the job when it comes to making such major judgments. Its *National Infrastructure Plan 2010*¹³ identifies some key issues relating to economic regulation, most notably a lack of clarity in the balance between regulators' economic, social and environmental duties; a lack of clear strategy and objectives; and weak dialogue between regulators on common issues including regulatory tools, competition and consumer affordability.

The recent BIS economic regulation paper says that regulatory decisions should be taken by bodies that have '*the legitimacy, expertise and capability to arbitrate between the required trade-offs.*'

Sectoral regulators need to have high levels of expertise in their particular sector as well as strong regulatory skills, without which they risk losing the confidence of industry and consumers alike. But any regulatory body which considers that relevant expertise exists solely within its organisation may also lose legitimacy.

One of the key regulatory skill sets is the ability to leverage the expertise of others, including both regulated firms themselves and consumers, while remaining alive to the existence of vested interests which may influence such external input. Only when all such parties have a chance to input both evidence and analysis is the regulator in a position to make a balanced judgment which is likely to be seen as legitimate.

¹³ *National Infrastructure Plan 2010*, HM Treasury, October 2010

A further critical dimension is the EU which legislates in all markets covered by UK economic regulators. Early and informed consumer input into the European policy making process is essential if overarching regulatory frameworks are to evolve and develop appropriately.

The need for external consumer input



Good regulatory decision-making requires effective input from all stakeholders including consumers. Regulated firms already invest significant resources in working with and influencing their regulator. This is wholly appropriate but inevitably can run the risk of affecting the balance of regulatory decisions unless there is also effective input on behalf of consumers.

If views from regulated firms were the only external input, information, intelligence and public debate would become one-sided, with insufficient challenge to the received wisdom shared by people on both sides of the regulatory relationship. Experience suggests that regulators and regulated businesses can sometimes frame issues in a similar way, with common views on what the key questions are, even if they may have different perspectives on the answers.

There needs to be some countervailing input that unapologetically favours the consumer interest, to give the regulator a wider range of perspectives and a more rounded evidence base on which to make decisions. This applies both to major strategic decisions and to more detailed matters such as individual licence or enforcement decisions. Such external challenge can improve the quality of regulation, by testing the robustness of the evidence and analysis underpinning decisions, providing different thinking and solutions, and raising new issues.

This independent perspective cannot be provided from within the regulator, although this in no way reduces the need for regulators to themselves have good consumer policy teams and input from their own advisers such as specialist panels.

It is important that regulators have primary objectives relating to consumer interests but that is not their only purpose – they do not work solely for consumers. Blurring the roles of regulator and consumer representative can serve to weaken both.

The Government has recognised that effective scrutiny of regulators requires independent external expertise. The BIS paper on economic regulation states:

'The actions of regulators need to be scrutinised appropriately, both at the level of specific decisions and in aggregate. In principle, scrutiny should be carried out by the body that has granted the regulator its mandate and obligations. For the most part therefore, economic regulators, whose primary remits derive from statute, should be scrutinised by Parliament. In order to fulfill its scrutiny tasks Parliament might, however, need technical advice from independent experts.'

An independent body representing consumer interests is an important part of the overall accountability framework for regulators.

If done properly, good consumer representation can make a major contribution to the quality of regulatory decision-making, helping economic regulators focus their resources on the right issues and make the right kinds of intervention. It can help build public trust in regulatory regimes and the markets being regulated, and so help to promote growth across the economy as a whole and act as a shield against decision by media headline. This requires real commitment to a grounded, evidence-based approach, with the right working culture.

In contrast, without a robust system of independent consumer representation, consumers may face significant additional costs and other forms of detriment. Unfair and unjust outcomes could raise major concerns about the legitimacy of these decisions and the bodies making them, which could in turn increase uncertainty for regulated businesses and investors.

Features of effective consumer input



Empowering individuals and groups of consumers will be ever more important in the years to come, but this will not be enough to ensure that consumers are fully involved in major decisions. There also needs to be effective consumer engagement by regulators (for example through qualitative and deliberative research); formal representation of consumers and their representatives in regulatory processes such as price control reviews; and policy work that is independent of regulators in terms of both the choice of topic and the analysis, backed by powers to gather information from regulated firms.

Expert consumer policy work typically encompasses work on market structures, barriers to entry, price controls and other regulatory tools, product design, charging structures, the relationship between input costs and retail prices, sales and marketing practices, billing, sustainability, treatment of disadvantaged consumers, withdrawal of service and debt recovery practices, customer service and redress, consumer information and empowerment, and consumer education. Many of these issues run across sectors, with benefits to be gleaned from a generic approach in many cases.

Effective consumer policy and representation requires a number of capabilities:

- Deep knowledge of the market
- Access to high quality research, market intelligence and other forms of evidence, providing insight into the consumer experience of markets
- Understanding that different consumer's experiences vary as a result of circumstances and needs
- The ability to identify current, emerging and likely future sources of detriment
- The ability to respond flexibly and rapidly to any new problems that arise
- The intellectual framework to analyse evidence and produce reasoned perspectives, for example balancing short- and long-term consumer interests
- Understanding of technical issues relating to products and services and how social, economic and technological changes are affecting markets
- The ability to learn from experience in different sectors

- An understanding of business and consumer behaviour and of the regulatory toolkit
- The ability to put views persuasively, build effective relationships, challenge received wisdom and achieve influence
- Working at local, regional, national, EU and international levels as appropriate

It also requires independence from regulators and certain statutory powers, for example to be a formal consultee with respect to certain regulatory processes, to request information from regulated firms; to make formal representations to the regulator and, where appropriate, to have powers of appeal to regulated firms that are symmetrical with those of the industry.

Current arrangements and need for reform



Consumer representation in regulated utility sectors of the economy is currently delivered through a patchwork of bodies. Consumer Focus covers energy, post, and (from June 2011) water in Scotland; Passenger Focus covers rail; and Consumer Council for Water covers water in England and Wales. Consumer Focus also works on the communications sector and there is a Communications Consumer Panel within Ofcom. The Air Transport Users Council covers air transport, based within the Civil Aviation Authority. Consumer Focus is a member of the European consumer organisation BEUC and works alongside it at EU level. In addition Which? and Citizens Advice carry out some valuable consumer work in these markets and the OFT can undertake market studies in areas where there is consumer detriment.

These arrangements have developed in an ad hoc way over the past 30 years and represent a legacy of different thinking within different government departments at different times. There is now an opportunity to create a more coherent and rational approach reflecting the common challenges facing consumers across all of these markets.

The Secretary of State for Business has said that he aims to cut down *'the complexity, confusion and waste which accompanies the proliferation of [consumer] bodies¹⁴.*' The BIS economic regulation paper highlights the need to strengthen the dialogue between regulators on common issues.

There are therefore significant cost efficiency and effectiveness reasons for bringing consumer representation together across the sectors concerned, in order to exploit the synergies, maximise use of specialist expertise, build a cross sector function with strong consumer appeal and trust, and ensure issues of consumer and political significance are effectively addressed by regulators and by Government over the next decade.

¹⁴ Public Bodies Bill – Changes to the UK Consumer and Competition Bodies, Statement by Vince Cable, 14 October 2010

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