

The potential role of Consumer Challenge¹ in energy network regulation in Australia: a think piece for the Australian Energy Regulator

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13 March 2013

¹ Terminology. The terms “consumer” and “customer” are often used interchangeably in the utilities sectors. In recognition of the fact that both COAG and the AER have chosen the term “consumer” and to provide consistency through most of the report, the term “consumer” has generally been used as the preferred term in this paper. However, the term “customer” is used in the sections about Ofwat in the UK and IPART in NSW as that is the term they tend to use. The actual term used—whether “consumer” or “customer”—has been preserved when reflecting usage in documents, names of organisations etc.

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Background

Network costs have risen significantly in recent years, particularly driven by the investment required to meet increases in peak demand. There is a major national debate about how to contain the growth in peak demand (and its associated costs) in the future. Customers, who have tended to be relatively passive users of networks, may in future, assisted by better price signals and technology developments, become more active participants delivering flexibility into the system that could help to manage and reduce peak demand.

The extent and effectiveness of consumer engagement in the processes of energy network regulation in Australia is at present considered limited. The reasons for this include the limited resources of consumer organisations and the complexities of network regulation that make it difficult for “ordinary” consumers and even their representative organisations to play an active part.

More effective engagement of consumers could help to deliver greater legitimacy of outcomes in energy networks. Consumer engagement may also increase through opportunities for more active participation to provide flexible demand response into the system – but this is likely to take many years to develop. In the meantime, the AER wished to examine the Consumer Challenge method of consumer engagement for the forthcoming price re-sets. COAG agreed in December 2012 to provide the funds to the AER to establish a Consumer Challenge Panel by July 2013.

The Consumer Challenge models developed by regulators in the UK are considered to be a useful starting point to assess how such a Panel could work in Australia. The AER thus commissioned this paper to:

- Outline the Consumer Challenge model used by Ofgem in Great Britain for the network price controls since 2008, the context and the rationale for introducing it
- Examine how it worked in practice and the lessons learned
- Consider its potential application in the Australian context, given the similarities and differences between Australia and Great Britain.

The paper also briefly outlines the Consumer Challenge approach that has been introduced by Ofwat, in 2012, for the water price control setting process in England and Wales.

Further information is available in the three published reports from the Ofgem Consumer Challenge Group.²

Executive summary

More effective engagement of consumers could help to deliver greater legitimacy of outcomes in energy networks. The AER has been examining the Consumer Challenge method of consumer engagement for price re-sets. COAG agreed, in December 2012,

² Ofgem, Consumer Challenge Group DPCR5 interim report, July 2009:

<http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/CFconsumerchallengegroup.pdf>

Ofgem, Consumer Challenge Group DPCR5 final report, March 2010:

<http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/CFconsumerchallengegroup23.pdf>

Ofgem, Consumer Challenge Group RIIO T1 and GD1, December 2012:

http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/RIIO%20and%20GD1_%20CCG_20-12-2012.pdf

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to provide the funds to the AER to establish a Consumer Challenge Panel by July 2013. The Consumer Challenge models developed by regulators (Ofgem and Ofwat) in the UK are considered a useful starting point to assess how such a Panel could work in Australia.

Ofgem Consumer Challenge Group (CC Group)

The first CC Group was set up by Ofgem in July 2008 for the electricity distribution price review leading to new price controls from April 2010 (DPCR5). The initiative was continued for the review of the electricity and gas transmission and gas distribution price controls, to come into effect in 2013 (RIIO T1 and GD1³) and the review of electricity distribution price controls to come into effect in 2015 (RIIO ED1).

The purpose of the CC Group was to act as a “critical friend” providing challenge throughout the Price Control Review to ensure that the consumer view was fully considered. This was an initiative of the regulator, Ofgem, in recognition of the limited nature of consumer engagement in price reviews, because consumer groups have limited resources. Ofgem sought to get consumer input into some of the more complex issues that it was unable to address through market research, to help ensure it had not missed any key issues so that the final package was a fair one for consumers. The CC Group acted in an advisory capacity to help inform the Authority’s decision-making process. Ofgem committed to taking the CC Group’s views seriously but was not obliged to act on them. The Authority (the formal decision making body of Ofgem) makes the final decisions based on various inputs and advice. Ofgem also did not expect members to sign up to the decisions or to indicate that they had done so.

Economic regulators in the UK have had a range of duties that encompass environmental, social and economic objectives since their establishment at privatisation in the 1980s and these have evolved through a series of legislative changes.^{4, 5} Ofgem therefore has to balance costs for current and future consumers and the costs of meeting environmental obligations. Whilst costs to consumers were an important component of the CC Group’s deliberations this was within a context of “value for money” – what outputs and outcomes do consumers want DNOs to deliver and at what price – i.e. the price/quality trade off.

The CC Group operated by having a number of full day meetings with the senior Ofgem staff working on the price review. The CC Group also met with the Committee of the Authority (the main decision making body on the price control) twice in each price review to outline the key points it wished the Committee to take into account and to discuss these with the Committee. These meetings were held at the same time in the price review process as the Committee were meeting the Distribution Network Operators (DNOs). The Group also met with the Network Operators once to ask them questions about key issues in their business plans.

What difference did the CC Group make in DPCR5?

The CC Group is not “claiming credit” for major changes in what Ofgem did. The CC Group were part of a process that involved Ofgem consulting consumer organisations,

³ RIIO – Ofgem’s new output led approach to price regulation. RIIO – Revenue = Incentives + Innovation + Outputs.

⁴ For a full account see: Owen, G. Sustainable development duties: new roles for UK economic regulators. Utilities Policy 14 (2006). pp208-17

⁵ Prosser, T. Law and the regulators, OUP, 1997.

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individual consumers (households and businesses), other consumers of the DNOs (such as retailers, developers and distributed generation owners) and other stakeholders, and the findings of market research amongst consumers. That being said, some of the key issues where the Group made a significant input into the development of Ofgem's final proposals included:

- Clearly defined outputs to ensure that consumers “get what they have paid for” and that the health of the network does not deteriorate requiring greater investment and higher prices for consumers in the future. One example is the Load Index (LI) which makes visible where it is expected that reinforcement expenditure should be directed and what impact it should achieve.
- Measures to improve connection service (guaranteed standards) and enable effective competition in connections.
- Ofgem revised the interruptions incentive scheme (IIS) to better reflect that there is limited consumer willingness to pay for further service improvements.
- A new incentive that rewards or penalises the DNOs according to how they fare on a broad measure of consumer satisfaction.
- The Low Carbon Networks fund supports trials of technologies, commercial and operating arrangements for the “smart grid” future. The CC Group, in particular promoted: that DNOs should bid in competition with each other, rather than each DNO receiving an innovation allowance; that DNOs should bid in partnership with others such as electricity retailers; that DNOs should share learning to maximise industry benefit.

Key considerations for setting up a Consumer Challenge Panel in Australia

- It makes sense for the regulator to use a number of different means of consumer engagement to assess the consumer interest, so that it can “sense check” specific ideas. It is not likely to be a good idea to create a monopoly provider of the consumer view!
- Clarity about the different roles of a Consumer Challenge Panel and an Energy Consumer Advocacy Body (if one is established) will be important. A memorandum of understanding between the two bodies may assist in this.
- There is no one “consumer interest” – consumers will have differing views.
- A Consumer Challenge Panel is not the solution to the problem of high network costs, but can be part of the process for making network regulation and networks more responsive, so that consumers are more likely to be paying for the level of network service that they want.
- Unlike Ofgem, the AER does not have any specific environmental or social duties. However, the AEMC Power of Choice review and various initiatives by the Commonwealth and State governments to promote initiatives such as energy efficiency, renewables, smart metering, time of use tariffs, mean that networks (and the AER) will be facing some similar challenges to those in the UK. It is likely therefore that a Consumer Challenge Panel in Australia would also engage with some of these broader issues.
- For all forms of consumer engagement there is a need to be honest with consumers about the scope for them to influence – for example, on reliability standards.
- The Panel could provide some challenge to the network businesses – ideally early in the process to allow the networks to incorporate this challenge in their proposals to the regulator.

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- It would also be sensible for the Consumer Challenge Panel to meet with consumer organisations.

Conclusions

Given the limited nature of consumer engagement in network regulation to date in Australia, a Consumer Challenge Panel is likely to add something of value to the process. However, the Consumer Challenge Panel is only part of a consumer engagement strategy for the AER, that will also include consultation with consumer organisations and individual consumers and the outcomes of consumer engagement undertaken by the network businesses.

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1. Consumer and stakeholder engagement

In recent decades and particularly in the last ten years or so, there has been an increase in the use of techniques to achieve greater accountability in decision-making by public and private sector bodies. This has come about partly as a result of calls for transparency and accountability from consumer and environmental groups, and partly due to recognition on the part of decision-makers that they are under greater scrutiny and that more effective engagement can help to reduce risks to processes, projects and policies. There has thus been an enormous growth in public consultation particularly by public bodies, such as government departments and regulators. Whilst stakeholder engagement will rarely deliver full consensus, early engagement of stakeholders can help to demonstrate that views have been given fair consideration in reaching a final decision. As a result, these decisions are likely to have greater legitimacy—acceptance and/or support—in the long term.

It is worth clarifying the difference between consumers and stakeholders in the context of engagement activities. “Consumers” implies engagement with those who use and pay for the service (end consumers and intermediate consumers, e.g. for distribution companies this will include retailers and distributed generation). “Stakeholders”, however, can include a broader constituency such as suppliers, employees, environmental groups, political representatives and people in their role as citizens (where their interests may be broader than as consumers).

Regulators will need to engage with consumers and other stakeholders, but the focus of this paper is on consumer engagement, so it will not address broader stakeholder engagement, expect to note that many of the same techniques may be applied to engagement with both groups.

Consumer engagement can take a number of forms:

- Public consultation – inviting anyone to respond to proposals, consultation papers, attend general consultation events.
- Consumer surveys – using surveys to obtain quantitative and qualitative information on consumer priorities – includes willingness to pay and willingness to accept surveys.
- Focus groups and consumer panels – bringing together groups of consumers for more in depth discussions to elicit their views (can be one-off or involve several sessions of deliberative consultation).
- Targeted consultation (one-off) – specifically seeking comments from targeted audiences such as consumer representative groups – either written comments or through consultation seminars, workshops etc.
- Consultative or advisory or challenge groups – bringing together a number of consumer experts or representatives for consultation, challenge and advice over a period.
- Negotiated settlement or formal constructive engagement – consumers (or consumer representatives) are given the role of negotiating some, or all, of the parts of a price determination with a regulated company.

The Consumer Challenge Groups set up by Ofgem and Ofwat in the UK are largely of the type of engagement outline in the fifth point above. However, both Ofgem and Ofwat also undertake the first four types of consumer engagement.

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Both Ofgem and Ofwat have ruled out the negotiated settlement approach at present. However, both regulators have enhanced the ways in which they will take into account, in their determinations, consumer engagement undertaken by the regulated companies. Ofwat requires the companies to set up their own customer challenge groups. During the recent Transmission and Gas distribution price reviews, under the RIIO model, Ofgem placed a greater focus on how stakeholder engagement informed the business plans. The Broad Measure of Customer Satisfaction (introduced as part of the DPCR5 electricity distribution price control in 2010) provides financial rewards and penalties to DNOs based on their service to customers, including the level and usefulness of stakeholder engagement, their effectiveness in dealing with the complaints received, and their handling of other contact with their customers.⁶

Negotiated settlements – formal constructive engagement

Negotiated settlement (formal constructive engagement) involves the users of a regulated monopoly and the monopoly owner negotiating to reach a settlement as to the costs to be funded and revenue to be collected from users. The role of the economic regulator can therefore be rather different from the traditional one of setting the price control. The regulator may manage the process and provide guidance, but the key feature is that the regulator accepts the settlement agreed between users and network owners and does not seek to make its own judgement about the outcome (either the full price determination or parts of it). “Typically the settlements are accepted by the regulator, obviating the need for a formal hearing and regulatory decision other than to adopt the terms of the settlement.”⁷

The negotiated settlement approach has been used in a number of countries and regulated sectors, although in most cases this has been in sectors where there is a small number of large consumers – for example, airports, where it is the airlines as “consumers” who are engaged, rather than passengers. There are pros and cons of negotiated settlement and it is not the purpose of this paper to examine them. However, they are mentioned to clarify that this approach is different from the CC Groups instituted by Ofgem and Ofwat. The company specific CC Groups that Ofwat has required the water companies to set up are also not tasked with a negotiated settlement role, although the regulator will take their views into account. To implement a negotiated settlement approach would require a group being established for each network business, made up of consumers or their representatives in the network’s area, as opposed to a single CC Group designed to provide advice and challenge to the regulator on sector wide issues.

⁶ Ofgem. DPCR5 Final Proposals (Decision Document), December 2009

⁷ Littlechild, S. A customer consultation process for the water and sewerage sectors. A paper for Ofwat 20 May 2010, p.19

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2. GB context and rationale for introducing Consumer Challenge by Ofgem

The first point to note is that the Ofgem CC Group was not introduced as a result of major public and/or political concerns. There was no government decision to set up such a CC Group, nor is there evidence of any Government pressure on Ofgem to do so. The CC Group was very much an initiative of the regulator, Ofgem, in recognition of the limited nature of consumer engagement in price reviews, because the process is considered highly technical and consumer groups have limited resources to engage.

Secondly, there are a number of consumer organisations very active in the energy sector in Great Britain. Until 2008 the statutory energy consumer body for England, Wales and Scotland was EnergyWatch. In 2008 the energy consumer functions were combined with similar ones in the post sector and the functions of the generic statutory consumer bodies for England, Scotland and Wales, to form Consumer Focus, which retains an energy team. The CC Group idea arose partly as a response to EnergyWatch being absorbed into Consumer Focus as it was likely to have fewer resources for energy work. Other groups active on the household consumer side include Which? (equivalent of Choice), Age UK and Citizens Advice. However, most of these groups, along with Consumer Focus, tend to engage mostly with retail issues.

By 2014 Consumer Focus will be abolished and most of its functions transferred to Citizens Advice. However, due to concerns about the potential loss of a specialist consumer advocate in the regulated industries sector (energy and post), the Government has agreed also to establish a Regulated Industries Unit, within Citizens Advice, that may in time also encompass water and transport.

On the business consumers side there are organisations including the Energy Intensive Users Group (EIUG), Major Energy Users Council (MEUC) and the Confederation of British Industry (CBI). There tends to be limited engagement of the electricity and gas retailers who could be seen as “consumers” of the network businesses and a proxy for the consumer interest. However, some retailers have taken active roles in network price reviews.

It is also important to understand the UK energy policy context in which Ofgem operates. Ofgem (and its predecessors, Offer and Ofgas) has, since the regulators were established at privatisation in the 1980s, had a range of duties that encompass environmental and social objectives as well as economic ones.⁸ However, in the last twelve years these duties have evolved through a series of legislative changes.⁹

Ofgem, has had social and environmental guidance from the Government since 2002, but this has been regarded as lacking impact.¹⁰ A secondary duty “to contribute to the achievement of sustainable development” was introduced for Ofgem in 2004. The 2008 Energy Act elevated this duty, placing it on an equal footing with Ofgem’s duties to ensure that reasonable demands for electricity and gas are met and that activities to supply electricity and gas can be financed. Ofgem’s primary duty was further modified in the 2010 Energy Act and is now “to protect the interests of current and future consumers, where, taken as a whole, those interests include the reduction of greenhouse gases and security of supply”. Ofgem therefore sets price controls in a

⁸ Prosser, T. Law and the regulators, OUP, 1997.

⁹ For a full account see: Owen, G. Sustainable development duties: new roles for UK economic regulators. Utilities Policy 14 (2006). pp208-17

¹⁰ DECC. Ofgem Review. May 2011.

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context in which it has to consider the interests of existing and future consumers and has to balance the fact that consumers today would prefer to pay less, with the need to avoid undue burdens on future consumers and meeting environmental obligations.

Since the late 1990s Ofgem had also been increasing its outward facing activities with consumer and other stakeholder groups. This was done partly by setting up Advisory Groups (one on social issues and one on environmental issues), chaired by the Ofgem Chairman, with representation from energy companies, consumer and environmental groups. It was also achieved through increasing participation of Ofgem staff in events organised by stakeholder groups, and Ofgem's own consultation events.

Network costs in GB are currently a smaller proportion of consumers' bills than they are in Australia. GB network costs are around 23% of an average household electricity bill and around 21% of an average household gas bill.¹¹ However, there is likely to be significant upward pressure on network costs in the electricity sector over the next decade due to the need for general reinforcement and to facilitate the low carbon energy system – including potentially major increases in electricity usage for heat and transport and the need to connect more distributed generation.

¹¹ Ofgem. Updated household energy bills explained. Factsheet 97. 31 May 2012. Average household electricity bill at that date was £470 and average gas bill was £704.

3. The Ofgem Consumer Challenge Group

A key point to note is that the rationale for establishing the CC Group was not primarily about reducing the cost of networks to consumers. Clearly costs were always likely to be an important component, but within a context of “value for money” or what outputs and outcomes do consumers want DNOs to deliver and at what price – what is the price/quality trade off?

Extract from Terms of Reference for the first Consumer Challenge Group:

“The Consumer Challenge Group is being set up to assist Ofgem in ensuring that the consumer view is fully considered during its Electricity Distribution Price Control Review. We already have a programme of consumer research as part of the review but wish to bring in additional consumer expertise for the following purposes:

- To enable us to get consumer input into some of the more complex issues that we are unable to address through market research.
- To provide a ‘critical friend’ from the consumer’s perspective ensuring that we have not missed any key issues and that the final package is a fair one for consumers.
- The [CC] Group will act in an advisory capacity to help inform the Authority’s decision-making process. Ofgem will commit to taking the [CC] Group’s views seriously and giving them due weight in the deliberation process but will not be obliged to act on the views expressed. The [CC] Group (or representatives of the [CC] Group) will be given the opportunity to present at key intervals to the Committee of the Authority with the same frequency as the Network Operators (DNOs).
- We would wish to name the members of the [CC] Group as being ‘consumer advisers’ – however we would not expect members to sign up to the decisions or to indicate in any way that they have done so.”¹²

The first CC Group was set up in July 2008 for the electricity distribution price review leading to new price controls from April 2010 (known as DPCR5). The DPCR5 CC Group had 6 members – 4 with knowledge and expertise relevant to household consumers and 2 with knowledge and expertise relevant to business consumers.

For the review of the electricity and gas transmission and gas distribution price controls, to come into effect in 2013 (RIIO T1 and GD1), a further 2 members were added to the CC Group.

For the review of electricity distribution price controls to come into effect in 2015 (RIIO ED1), 7 members were appointed (3 of these were members who had been on both the DPCR5 and T1/GD1 groups, the others were new appointments).

The discussion sessions with Ofgem staff were chaired by a senior manager of the Consumer Policy team. The CC Group members decided that one of them should chair the sessions with the DNOs and CC Group decision making sessions (i.e. sessions where the CC Group agreed key points for meetings with the Authority and

¹² Ofgem. Consumer Challenge Group Briefing, June 2008.

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the network businesses and for external communications). The sessions with the Committee of the Authority were chaired by the Authority Chairman.

CC Group members are paid for their time commitment. This was considered essential to ensure that members could and would devote sufficient time to the task. As a result most members have attended virtually all meetings. In advisory groups where members are not paid, attendance at meetings can be sporadic and often tends to tail off after the first few meetings. Also there can be a tendency to substitute attendees which can have a detrimental impact on continuity. As these were individual appointments rather than representative ones, no substitution was allowed.

Consumer Challenge Group for Electricity Distribution networks price control 2010-15 (DPCR5)

The DPCR5 team held nine full-day meetings with the CC Group over 17 months of the price review period. The Ofgem staff team briefed the CC Group on emerging proposals and the CC Group provided challenge, feedback and suggestions. In Ofgem's words "The [CC] Group has offered valuable insight and advice on the consumer focused elements of the price control package."¹³

The CC Group met with the Committee of the Authority (the main decision making body on the price control) twice, to outline the key points it wished the Committee to take into account and to discuss these with the Committee. These meetings were held at the same time in the price review process as the Committee were meeting the DNOs.

The CC Group met with the Distribution Network Operators (DNOs) once to ask them questions about key issues. This was a single "round table" meeting with a representative of each of the DNOs. Questions discussed with the DNOs at this meeting included:

- DNOs engagement with consumers to date and how they can improve
- Worst served customers – how to identify and how to deal with.
- Connections – time taken, scope for competition
- Potential new challenges and opportunities for networks (e.g passive to active, smart meters).

The CC Group published an interim and final report.¹⁴ These reports were written by the CC Group and published on its behalf by Ofgem.

Other consumer research and engagement by Ofgem for the price control reviews

Ofgem undertook quantitative and qualitative consumer research at various stages of the price control reviews on consumer priorities for service improvements, indicators of willingness to pay and worst served consumers.¹⁵

The Ofgem Consumer First Panel was set up in 2008 – the same year as the CC Group. This Panel consists of 100 "everyday" household consumers from five different locations in Great Britain who meet in a series of deliberative workshops (reports are on the Ofgem website). The Panels have considered retail and network

¹³ Ofgem. Electricity distribution price control review. Final Proposals. December 2009. p12-13.

¹⁴ Web links at reference 1.

¹⁵ For example : Accent. Expectations of DNOs and willingness to pay for improvements in service. Ofgem, July 2008.

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issues, environmental impacts and issues such as smart meters and flexible (e.g. time of use) tariffs.

On network price controls the Panel members were able to identify key areas where consumers would be able to engage but tended to the view that their contribution would be limited because of the specialist and technical nature of many of the issues. They thought they as Panellists (having been through the Panel process) were likely to be better informed than the average consumer, but still considered that this was a task more for expert consumer representatives.¹⁶ Additionally, following the introduction of RIIO (see below), the Panel was used to consider consumer priorities for price reviews. When presented with the main outputs, consumers prioritised their importance, with safety and reliability being key.

RPI-X@20 review by Ofgem

As part of the RPI-X@20 review of price controls, Ofgem considered various options for the future of consumer engagement. It ruled out moving to a negotiated settlement/constructive engagement approach at that stage.

“We do not think it is appropriate to delegate responsibility for agreement of network regulatory decisions to consumer representatives, network users or other parties. We have concerns that the interests of these parties are not sufficiently aligned, with those of final consumers (existing and future), to delegate primary responsibility to them to agree regulatory decisions. It is also not clear which body would be able to represent the interests of future consumers. ... We also have concerns regarding their current access to resources, the current levels of expertise of all but a very small number of individual consumer representatives and their appetite to engage in this way.”¹⁷

However, Ofgem did note that this might be worth re-examining in the future. “We think there may be a future role for consumer representatives, network users and potentially other parties in agreeing decisions on the regulatory regime with network companies. The transition to a model which facilitates this may be appropriate in the event that the networks begin to have greater interactions with consumers due to changes in their role e.g. if they were to play a part in the roll-out of smart metering... Such an approach may also become appropriate in the event that parties secure access to the required resource and expertise to engage in this way and to effectively represent the interests of consumers. They would also need to have the appetite to engage in discussions of this nature. At present, we are not convinced that this is the case but we recognise that parties are likely to develop expertise and interest in the process through the enhanced engagement approach.”¹⁸

In January 2010, Ofgem confirmed that “We think effective consumer engagement would be best achieved by encouraging network companies to engage with consumers on an ongoing basis and complementing this with our own enhanced consumer engagement as part of the price review process.”¹⁹

¹⁶ Opinion Leader. Ofgem Consumer First Panel. Research from the Third Events, October 2009.

¹⁷ Ofgem. Regulating energy networks for the future: RPI-X@20 Delivering outcomes: Consumer engagement in the regulatory process. Ofgem October 2009. p.15

¹⁸ Ibid. p.17

¹⁹ Ofgem. Regulating energy networks for the future: RPI-X@20 Emerging Thinking - Enhanced engagement, Ofgem, January 2010. p.4

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In its RPI-X@20 decision document,²⁰ Ofgem set out the details of its enhanced engagement approach that would:

- encourage network companies to engage proactively with consumers. This includes developing commercial relationships with users of the network and building on relationships with other stakeholders (e.g. environmental groups)
- develop the stakeholder engagement process reflecting those issues that stakeholders are most likely to wish to, and be able to, influence
- facilitate discussions between government, other regulators, network companies and stakeholders at each price review.

Ofgem therefore decided to continue with the Consumer Challenge Group (CC Group), Consumer First panels and market research and also established the multi stakeholder Price Control Review Forum (a member of the CC Group attends). These approaches were broadly supported by stakeholders (consumer organisations, networks, energy retailers, environmental groups). Summing up its approach Ofgem said:

“The Authority, with its duty to protect the interests of existing and future consumers, will continue to take a balanced approach to assessing the price control. We will commit to providing a transparent explanation of how we have made our decisions and how we have considered the balance between existing and future consumers.”²¹

RIO T1 and GD1 Consumer Challenge Group

RIO is the new framework (to replace RPI-X) for regulating the networks. RIO stands for Revenue = Incentives + Innovation + Outputs.

The Consumer Challenge Group (CC Group) for RIO T1 (gas and electricity transmission) and GD1 (gas distribution) met with the Ofgem RIO T1 and GD1 teams 10 times over the 2 year price review period (2010-12). The CC Group also met with the Committee of the Authority twice. These meetings were held at the same time in the price review process as the Committee were meeting the transmission and gas distribution companies.

The CC Group met with the transmission and distribution companies on a one to one basis in 2011 to discuss their business plans. This was felt by the CC Group to be more useful than the roundtable with all DNOs held under the DPCR5 CC Group.

The key areas of focus for the CC Group for both RIO-T1 and RIO-GD1 have been:

- overall quality and content of the companies' RIO business plans
- scope and quality of the companies' stakeholder engagement including stakeholder surveys
- potential impact of the proposals on charging volatility
- how innovation could be incentivised in the price controls.

Price Control Review Forum (PCRF)

Ofgem established separate PCRF groups for RIO-T1, RIO GD1 and RIO-ED1. The PCRF groups meet quarterly during the reviews to provide input to Ofgem about a range of aspects of the price controls. The PCRF groups include the networks, retailers, renewables and distributed generation companies, DECC (the

²⁰ Ofgem. RIO. A new way to regulate networks. Final decision. October 2010. p.16-17

²¹ Ofgem. RIO. A new way to regulate networks. Final decision. October 2010. p.17

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Government department), consumer (business and household) and environmental organisations. A member of the Consumer Challenge Group attends the PCRFB meetings to provide a link between the two processes.²² Full terms of reference are available on the Ofgem website along with notes of the PCRFB meetings.

The role of the price control review forum (PCRFB) is to:

- allow Ofgem and network companies to hear the views of interested parties;
- bring together all aspects of stakeholder engagement being undertaken by Ofgem, network companies and interested third parties;
- allow Ofgem to evaluate its outputs and incentives proposals and for Network Operators to evaluate their business plans;
- discuss the output tradeoffs that may need to be made, in light of competing stakeholder interests, and to understand the reasons behind different views.

Consumer engagement by network companies under RIIO

A key principle of RIIO is for companies to develop a well-justified business plan through enhanced stakeholder engagement. Ofgem has stated that companies that rise to this challenge may benefit from proportionate treatment and “fast-tracking”. Fast-tracking will allow the companies to conclude their price control up to a year ahead of the standard timetable.

Below is an extract from Ofgem’s initial assessment of transmission companies’ business plans under RIIO-T1²³. This also notes some of the comments that the CC Group made upon the plans.

“ 3.7 There is scope for further development in all of the stakeholder engagement processes. All of the companies could do more to demonstrate how their engagement has impacted areas of their plans. Currently, views are generally quoted where they agree with the company’s position. The companies need to demonstrate the range of views received and how they challenged stakeholders’ views to reach a position. In addition, for SPTL and SHETL there is a need to engage with a wider range of parties and demonstrate how intelligence gained from the process has been used to shape plans and improve performance. The [CC Group] noted that all companies could do more to engage with local communities and the voluntary sector. They further noted that the interaction with both distribution and supply companies was important and that more evidence should be provided on the interactions with these parties.

3.8 The [CC Group] also highlighted the need for all of the transmission companies to explore and explain in more depth how their business planning reflected their understanding of the needs of future consumers and system users, particularly in the light of the significant new investment being planned.”

Following publication of the initial assessment by Ofgem of the business plans, all of the companies undertook considerable additional consumer engagement to refine the plans. In RIIO T1 the two Scottish electricity transmission companies were fast tracked, concluding their price determinations in April 2012, whereas National Grid’s (electricity and gas) were not fast tracked and concluded in December 2012.

²² The CC Group has rotated this role amongst its members.

²³ Ofgem. Initial assessment of RIIO T1 business plans. 24 October 2011. p.7

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/busplanannex.pdf>
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/busplanletter.pdf>

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Examples of some issues discussed by the Consumer Challenge Group in DPCR5

Over the period of the review the CC Group provided challenge on many aspects of the price review. Some of the issues discussed included:

- Willingness to Pay (WTP) research – some research conducted just prior to the GFC suggested considerable consumer willingness to pay for network measures that would contribute to carbon mitigation. The CC Group raised questions about whether this would still hold true, given that costs in other parts of the electricity value chain had risen as well as other costs that consumers were facing and with rising levels of unemployment. The CC Group encouraged Ofgem to undertake some more up to date research. The CC Group also discussed with Ofgem the limitations of WTP research (some members of the CC Group had particular experience in this type of research).
- Network reliability - research undertaken by Ofgem suggested that consumers did not want any deterioration in security and availability of supply but they were not willing to pay for significant improvements. CC Group confirmed this was likely to be a reasonable assessment of consumers' preferences.
- Equalising treatment of capital and operating expenditure (CAPEX and OPEX), as a means of changing incentives on the companies and helping to encourage demand side and non-network solutions.
- A key issue for the CC Group was how DNOs engage with their consumers, how company culture can become more proactive and consumer facing and how far incentives and regulation can encourage this cultural change. Having met with the DNOs, the CC Group felt that there was a lot of work to be done, which the DNOs themselves also recognised. Most consumer contact is with suppliers and DNOs are largely invisible to consumers. The need for DNOs to enhance and develop their relationships with consumers is likely to grow in the future.
- Worst served customers – The CC Group discussed this issue at some length, as it raises some important issues. Clearly, customers who are poorly served (many interruptions) would wish for a much better service. However, delivering better service to some of the worst served could prove very costly and the costs will be borne by all customers of the network. The CC Group discussed how much it would be reasonable to spend to improve service to the worst served. Out of these discussions (and research by Ofgem) arose the idea of a cap on the amount spent per worst served customer in terms of network upgrading, to assist as many customers as possible for a given level of resources.

What difference did the Consumer Challenge Group make in DPCR5?

It is important to recognise that the CC Group is not “claiming credit” for major changes in what Ofgem did. This was not the aim of the process or of the CC Group. The CC Group was involved in an iterative process with Ofgem over a long period. The value for Ofgem was in engaging with people who have experience in energy and consumer issues (and, to varying degrees, of economic regulation) who could bring a different perspective from the staff team at Ofgem and also with a different brief from consultants engaged to advise Ofgem on particular issues. The CC Group recognised that they were part of a process that involved Ofgem consulting consumer organisations, individual consumers (households and businesses), other consumers of the DNOs (such as retailers, developers and distributed generation owners) and other stakeholders, and the findings of market research amongst consumers.

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That being said, some of the key issues where the CC Group made a significant input into the development of Ofgem's final proposals are:

- *Clearly defined agreed outputs* that Ofgem expects the DNOs to deliver in return for the revenues they are allowed to collect from consumers. The CC Group felt that this was important to ensure that consumers “got what they had paid for” and that the general health of the network does not deteriorate requiring greater investment and higher prices for consumers in the future. In return for the revenues they receive from consumers over DPCR5, DNOs will be required by the end of 2015 to have delivered an agreed package of output measures. One example is the Load Index (LI) relating to general reinforcement. DNOs have ranked each applicable site (e.g. substation) from 1 to 5 where 'LI1' represents sites with significant spare capacity and 'LI5' captures sites that are fully utilised and require intervention. This Load Index thus makes visible where it would be expected that expenditure should be directed and what impact it should achieve.
- *Connections* – There had been many complaints from consumers (notably developers, businesses, distributed generation) about the time taken to secure connections and the costs. This was an area where the two business consumer experts on the CC Group were particularly able to provide evidence and comment. As a result, Ofgem introduced measures to: significantly improve the level of service to consumers seeking a connection to the distribution network; enable effective competition in connections. New guaranteed standards and licence conditions entitle consumers to compensation if they do not receive connection quotes within a defined timeframe and if their connection is not energised within the timeframe agreed with the DNO. DNOs are not able to recover the cost of making compensation payments and, if they do not succeed in rapidly improving on pre-2010 performance levels, shareholder earnings could be reduced by up to 100 basis points (pre-tax) over the five year period.
- *Targets and incentives for network reliability*. Ofgem revised the interruptions incentive scheme (IIS) to better reflect limited consumer willingness to pay (as evidenced by consumer surveys) for further service improvements. Ofgem did not give DNOs any ex-ante allowances for improvements in interruptions performance.
- *A new incentive* that rewards or penalises the DNOs according to how they fare on a *broad measure of customer satisfaction*. The measure will be based on a satisfaction survey (interruptions, connections and general enquiries); a complaints metric (unresolved and repeated complaints, decisions made by the Ombudsman) ; and stakeholder (suppliers, IDNOs, ICPs, Local Authorities, developers, DG consumers, environmental organisations) views of the DNOs' approach to engagement and outcomes from the engagement.
- *The Low Carbon Networks fund* aims to stimulate culture change, innovation and trials of new technologies, commercial and operating arrangements for the “smart grid” future. It enables DNOs, in partnership with others, to help deliver a low carbon electricity sector. The CC Group, in particular promoted: the idea that DNOs should bid in competition with each other for projects to be supported through the fund, rather than each DNO receiving an innovation allowance; that DNOs should bid in partnership with others such as electricity retailers so that the projects would test not just technologies but also the commercial arrangements needed to make this work in a disaggregated electricity value chain; that a condition of participating is that DNOs will have to share learning (including the

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lessons learned from projects that "fail") to maximise industry benefit. The partnership approach is considered particularly important as this provides the DNOs with access to additional expertise and other sources of finance. Ofgem also said that if DNOs did not engage with these interested parties, it will consider further action, including a new licence condition that would allow Ofgem to require DNOs to let other parties run trials on their networks.

Ofgem's view of some of the key issues on which the CC Group made a difference is outlined in their Final Proposals for DPCR5:

“In particular they have helped us to develop and refine our proposals for:

- improving competition and service in connections for domestic, business and DG consumers and those competing with DNOs to provide connections services,
- environmental measures, particularly the scope and mechanics of the Low Carbon Networks fund (LCN fund) and the losses incentive,
- the three components of the broad measure of consumer satisfaction: consumer satisfaction survey, complaints metric and DNO stakeholder engagement,
- the "use it or lose it" allowance for improving service to worst served customers, a cap of £1,000 on the amount that can be spent on any individual worst served customer to ensure the benefits of the fund are spread across a number of worst served customers, and
- the introduction of network output measures, where DNOs must commit to achieving a defined set of outputs in return for the money that they receive from consumers. The [CC] Group was keen to ensure that consumers are able to understand what they will receive in return for their distribution charges and that those DNOs who fail to deliver these outputs, without good reason, are held to account.

As we have developed Final Proposals the [CC] Group has been able to inform our discussions on the overall DPCR5 package and particularly the calibration of incentives and how we should apply our analysis of RoRE in arriving at a decision on the cost of capital. We have also benefited from the perspective that the business representatives on this panel have brought to the debate on the treatment of pension costs.²⁴

The CC Group also stressed throughout that Ofgem needed to have a clear narrative in its DPCR5 documents explaining how its thinking had developed over time and how it has reached its final decisions. This includes outlining the issues considered and how Ofgem has taken account of the views raised by consumers and other stakeholders.

What went well in the Consumer Challenge process

The CC Group found the experience valuable and feel that it made an important contribution to the development of the DPCR5 Price Control. Some of the key factors that contributed to this positive view were:

- The CC Group was set up at an early stage in the DPCR5 process and thus had the opportunity to contribute when its views could be taken into account. For RIIO TD1 and GD1 and for ED1, the CC Group was established right at the start of the

²⁴ A key issue in respect of pension costs was how quickly deficits in pension funds should be reduced.

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process. Being involved at this stage meant that the CC Group could be confident that Ofgem was open to its input and was not just seeking ratification of decisions.

- Ofgem indicated the areas on which they wanted the CC Group's views, but the CC Group was able to determine what it most wanted to cover in the Challenge sessions. Thus whilst there was an overall plan there was also flexibility to vary this as new issues emerged.
- Having sufficient time in the meetings to discuss issues fully.
- The time commitment of the Director of Distribution (who led the DPCR5 review) and her senior staff to the Challenge sessions, which meant that the CC Group were confident that they were providing their views to the relevant people at the right times.
- The mixture of members (household and business, environmental as well as consumer knowledge) meant that the Group's members were also able learn from and challenge each other. The inclusion of members with environmental expertise was important in the Great Britain context given the environmental objectives of UK energy policy and of the regulator.
- The fact that this was not a stakeholder group but an expert group, meant that members were able to speak as individuals, rather than having to provide an organisational policy line. It was also helpful that the CC Group was not expected to reach a consensus. CC Group members did provide differing views and did disagree from time to time!
- Having meetings with the Authority Committee at various stages in the process to present and discuss the CC Group's views.
- Having the opportunity to meet the Distribution Network Operators.

The CC Group was able to see places in the final proposals where Ofgem referenced their input and that from consumer research and other consultation with consumer groups. This is important as it shows that Ofgem have taken consumer input seriously – something that the CC Group stressed to Ofgem would be important.

Ofgem have also stressed that they see a key benefit of the CC Group as being the role it has played in helping to build recognition of the value of consumer engagement and capacity to undertake it, within the regulated businesses themselves.

What could have gone better in the Consumer Challenge process

There were a few areas in DPCR5 where the CC Group felt the process could have been improved.

- An earlier and fuller briefing for stakeholders on the role of the CC Group and how it fitted into Ofgem's broader consultation and consumer research activities during the price review process.
- Everyone within Ofgem fully understanding the role of the CC Group and its terms of reference and what would be said publicly by the CC Group.
- A further meeting with the DNOs, particularly to discuss the Low Carbon Networks Fund, would have been useful. The CC Group found the individual meetings with the networks business conducted under RIIO TD1 and GD1 more useful than the roundtable with DNOs under DPCR5.
- It would have been useful for the CC Group to have met other stakeholders – such as suppliers and the relevant Government department (Department of Energy and Climate Change). Under RIIO TD1 and GD1 and ED1, there is an opportunity to do this at the Price Control Review Forum sessions.

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4. Ofwat approach to customer challenge

Ofwat is the economic regulator for water in England and Wales. The water industry in England Wales was privatised in 1989 and consists of 10 large water and sewerage companies, plus 14 water only companies. All operate as local monopolies.

At the 2004 and 2009 price reviews, Ofwat carried out joint research with the Consumer Council for Water (CCWater – the statutory consumer organisation) and other stakeholders to assess how acceptable the companies' proposals were likely to be to their customers. In 2009, Ofwat also required the companies to develop strategic plans to provide a longer-term context for their five-year business plans, and to demonstrate how these reflected customers' views.

CCWater established discussion forums with each company, the local Environment Agency and the Drinking Water Inspectorate (DWI) – the Quadripartite Forums. The Forums met at key stages throughout the process and CCWater reported that the open discussions between companies and other stakeholders improved understanding.

At each price review, while Ofwat did receive comments from customers and their representatives and other stakeholders, engagement varied. Key factors were the complexity of the information, the process and the relative resources and expertise available to different stakeholders. Given the challenges ahead and the central importance of customers' views, Ofwat felt there was a need to examine new approaches to customer engagement that take into account:

- the extent of the influence that customers can have
- the needs and interests of different types of customers
- regional differences
- willingness and ability to engage.

As with Ofgem, this was very much an Ofwat rather than government initiative. Consultation on a new approach began in October 2010, although Ofwat had been working internally on the issue for some months before that.²⁵ An independent review of the role of Ofwat and of the arrangements for consumer representation in the sector was commissioned by the Government and started in September 2010. This review reported in July 2011.²⁶ The review concluded that Ofwat needed to engage more effectively with the full range of stakeholders. The final report broadly endorsed the approach that Ofwat was in the process of developing for customer engagement.

In August 2011²⁷ Ofwat set out that it wished to see a three-tiered approach to enabling customers to engage with and influence their companies' business plans:

- “Through direct local engagement between each company and its customers to understand customers' views, to inform development and test acceptability of the company's plan.
- Through company specific customer challenge groups that will...challenge the shape of each company's overall plan and the way the companies meet their legal obligations (for example, on drinking water quality and the environment)...The groups will play an important part in considering evidence of a company's direct

²⁵ Ofwat. Involving customers in the price setting process – a discussion paper. Ofwat, October 2010

²⁶ Gray, D. Review of Ofwat and consumer representation in the water sector. Defra, 2011.

<http://www.defra.gov.uk/publications/files/ofwat-review-2011.pdf>

²⁷ Ofwat. Involving customers in price setting – Ofwat's customer engagement policy statement. Ofwat, August 2011

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customer engagement, discussing and challenging how the company has responded in its business plan. The groups will advise Ofwat on how well this has been done.

- Through a sector-wide customer advisory panel to influence and inform Ofwat's decisions on those issues where Ofwat will apply consistent policies or assumptions across the water and sewerage sectors. This panel comprises members with the expertise and experience to inform and challenge Ofwat on a number of key sector-wide assumptions, such as the cost of capital, and provisions for pensions and energy. Membership includes CCWater as the statutory (legal) water customer representative. It also includes other customer representatives, such as big businesses, which are also often customers of several water companies. The panel will not duplicate the companies' own engagement with business and other customers. Nor will it advise on or challenge individual company business plans."²⁸

Ofwat has clarified the extent to which customers will influence the process of price determinations. "Customer engagement will be an important factor when we consider whether to accept a company's business plan. But it will not be the only one, as some things cannot be determined solely by customers' views. And sometimes, we have to consider the interests of future customers, as well as those who are able to express a preference now. So how much weight we place on customer engagement will depend on several factors."²⁹

Water company customer challenge groups

The customer challenge group model builds on the quadripartite and Wales PR09 forum discussions at the 2009 price review. But as well as other regulators (EA, DWI and Natural England), the statutory consumer body Consumer Council for Water (CCWater) and the company itself, the groups include:

- local authorities and business representatives
- other consumer organisations – e.g. Citizens Advice, Age UK
- environmental organisations.

Ofwat has recently (January 2013) set out more detail on how it expects the customer challenge groups process to operate.³⁰ This clarifies that each group will challenge:

- the quality of the company's customer engagement; and
- how well the company's proposed outcomes and outcome delivery incentives reflect their customer engagement, and customers' views and priorities.

Ofwat expects the customer challenge groups to be particularly important following the draft determination stage and at the stage that companies are making menu choices.

Ofwat Customer Advisory Panel

The Ofwat Customer Advisory Panel has 11 members. 3 come from organisations that focus on household customers. There are 3 with a focus on major companies; 3 from organisations concerned with small and medium business users; one from a

²⁸ Ibid.

²⁹ Ibid.

³⁰ Ofwat. Setting price controls for 2015-20 – framework and approach: a consultation. January 2013. http://www.ofwat.gov.uk/pricereview/pr14/pap_con201301framework.pdf?download=Download#

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farming/landowners organisation; one from government procurement. The members were appointed on the basis of their expertise and in an individual capacity and not as a representative of any particular organisation.

The panel met four times in 2012 and its terms of reference and minutes are published on the Ofwat website. This panel considers some of the same sorts of issues as the Ofgem CC Group and has a similar way of working – discussing issues with various Ofwat team members working on the price controls. However there are some important differences. It will not meet with the companies (this is the role of the company specific customer challenge groups). And it is not intended that it will meet with the Ofwat Board. The customer challenge groups’ views “will inform the work of the Ofwat Executive and be taken into account and explicitly referenced in the recommendations that the Executive puts to the Ofwat Board when it makes decisions on price setting methodology or determinations.”³¹

³¹ Ofwat. Involving customers in price setting – Ofwat’s customer engagement policy statement. Ofwat, August 2011

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5. Australian context for introducing consumer challenge

Network costs are a more significant part of the consumer's bill in Australia than in the UK (45-50% compared to under 25% in the UK). Therefore the potential for consumer engagement in the price setting process to deliver outcomes that have an impact on consumers' bills could be much larger.

As far as the electricity networks are concerned, the AER operates in the context of the National Electricity Objective (in the National Electricity Law): "to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to –

1. price, quality, safety, reliability, and security of supply of electricity; and
2. the reliability, safety and security of the national electricity system".

The AER must, in performing or exercising an AER economic regulatory function or power, "perform or exercise that function or power in a manner that will or is likely to contribute to the achievement of the national electricity objective."

Unlike Ofgem in Great Britain, therefore, the AER does not have any specific duties or powers in respect of environmental or social (distributional) considerations. However, the AEMC Power of Choice review and various initiatives by the Commonwealth and State governments to promote energy efficiency, renewables, smart metering, time of use tariffs and so on mean that networks (and the AER as their regulator) will be facing some similar challenges to those in the UK. It is likely therefore that a Consumer Challenge Panel appointed in Australia would also engage with some of these broader issues.

There has been relatively limited formal consumer engagement in the network regulatory process in Australia to date. The AER publishes consultation papers and holds a public forum in each network pricing re-set process. Engagement in these forums has tended to be greater for business rather than household consumers and the format is mostly a series of presentations with question and answer sessions. Other engagement is conducted on a project by project basis as appropriate. Issues papers and forums are scheduled to coincide with key milestones, such as electricity distribution resets in specific states. Recently, the AER endeavoured to increase the level of consumer engagement during the preliminary stages of the NSW & ACT electricity distribution determination – a range of discussion papers were issued and stakeholder forums held.

On the retail side however, consumer engagement has been much greater and there are a number of consumer and social welfare groups who are very engaged on retail market issues.

The National Energy Retail Law (NERL) required the establishment of a Customer Consultative Group (CCG) to provide advice in relation to the AER's functions under the energy laws affecting energy consumers across participating jurisdictions. The inaugural CCG was appointed in 2009 to enable informal consultation on the development of retail guidelines and to assist the AER in developing an understanding of retail issues prior to the commencement of the National Energy Retail Law and Rules in some jurisdictions on 1 July 2012. The AER has briefed the CCG on network issues from time to time. In 2011 the AER reconstituted its CCG for a two year period ending in late 2013. CCG meetings are held up to three times a year.

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There are currently nine members of the CCG who sit as representatives of their organisations. These organisations are the leading social welfare and consumer organisations in Queensland, New South Wales, Victoria, South Australia and Tasmania, mostly with a particular focus on low income and vulnerable household consumers.

Membership provides participating organisations with the opportunity to inform the AER about issues that impact on the groups they represent and meet with other consumer representatives to discuss energy consumer issues. Members consult with their constituency outside the CCG meetings and provide comment on:

- issues and energy market developments affecting energy consumers that fall within the scope of the AER's functions under the National Electricity Law, the National Gas Law and the National Energy Retail Law;
- information dissemination strategies and appropriate external networks available to enhance communication with community and consumer groups and energy consumers; and
- issues as requested by the AER.

The AER also participated in the Joint Implementation Group (JIG), established by the Standing Council on Energy and Resources to coordinate jurisdictional processes to implement the new retail market framework.

A number of the state based regulators have established consumer consultative bodies and/or have undertaken various consultation activities. These have mostly been in relation to retail market issues – not surprisingly as that is their main area of jurisdiction.

Consumer engagement by energy regulators in Australia has therefore been mainly focussed on retail market issues. It is also the case that (as in the UK), consumer organisations tend to be much more engaged in energy retail market issues than in the networks side, as it is in the retail market that the highest profile issues affecting their constituency have occurred to date. As far as network regulation is concerned:

“A significant challenge for consumer groups is determining which topics (e.g. operating expenditure or cost of capital), they are best targeting to both benefit their constituents and meaningfully participate in the regulatory process. This is particularly important given the technical nature of the regulatory environment and their limited resources.”³²

Another important contextual factor to note is that there is no national energy consumer body in Australia, although it is looking increasingly likely that there will be one, in recent proposals from COAG.³³ Thus, at present, the generalist consumer organisations who are members of the AER's CCG (and other generalist consumer organisations in Australia such as Choice), have to fit in their engagement in energy issues along with that in other sectors.

A number of network businesses' have established Consumer Consultative Committees that provide input into policy, planning and decision making. There is limited information available on the activities of these committees and how they impact upon decisions made by the network businesses. The AEMC has proposed that

³² AER. Summary of consumer engagement in Australia. December 2012 (note provided to the author by the AER).

³³ COAG Energy Market Reform. Implementation Plan. December 2012.

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network businesses should in future engage in a formal consultation process with retailers and consumers when setting their tariffs.

IPART review of customer engagement

IPART in NSW has undertaken a review of the role of customer engagement in the sectors that it regulates (water, energy retail, transport).³⁴ The review sets out IPART's expectations for customer engagement by regulated water businesses.³⁵ IPART considers that this should focus "only on their proposals in relation to discretionary operating and capital expenditure and changes in price structure". IPART took the view that "it is not appropriate for us to consider customer engagement in relation to all aspects of a regulated business' pricing proposal, particularly those expenditures required to comply with legislative or regulatory requirements. However, we consider it appropriate when expenditure is discretionary, because the link between this proposed expenditure and customer preferences is required to establish the efficiency of the proposed expenditure, an important task for an economic regulator."³⁶

IPART will encourage regulated water businesses to:

- provide evidence of customer engagement for discretionary operational and capital expenditure and for proposed changes to price structure.
- undertake best practice customer engagement, having regard to the costs of engagement.
- consult customers early, before price proposals are submitted.
- Businesses must also provide a separate, short, plain English summary of their price proposal in addition to their submission to IPART.

IPART also considered that it must provide guidance to the businesses before the price review process begins; assist stakeholders to build their capacity to participate effectively; and expand its suite of communication channels. IPART has not set up a Customer Challenge Group within IPART.

³⁴ IPART 'Customer engagement on prices for monopoly services', August 2012. www.ipart.nsw.gov.au/Home/Industries/Research/Reviews/Customer_Engagement/Customer_Engagement_on_Prices_for_Monopoly_Services_2011/10_Aug_2012_-_Release_Final_Report/Final_Report_-_Customer_engagement_on_prices_for_monopoly_services_-_August_2012

³⁵ IPART did not consider it appropriate to apply the customer engagement framework to the energy retail or public transport sectors. The reasons included, the existence of competition in energy retail and lack of a legislative mandate for customer engagement as a factor to consider in determining prices.

³⁶ IPART 'Customer engagement on prices for monopoly services', August 2012. p. 12.

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6. Potential role of Consumer Challenge in Australia

At the COAG meeting on 7 December 2012, COAG members agreed to provide the funds to the Australian Energy Regulator (AER) to establish a Consumer Challenge Panel. This formed part of a package of electricity reforms “designed to return the interests of consumers to the centre of Australia’s electricity markets”³⁷, in response to major public and political concerns about energy prices, the “gold plating” of networks etc.

The Economics Editor of the Financial Review, in December 2012, wrote that “The consumer challenge panel could play a pivotal role in all three big political challenges in power reform”.³⁸ He identified these as: to persuade state governments to accept the higher risk of blackouts in order to reduce “gold-plating” of the network; to deregulate retail electricity prices and allow time of day pricing to reduce the peak loads and the massive investment needed to meet them; to persuade the Coalition governments in NSW and Queensland to privatise their state-owned electricity assets.” When even informed media commentators can write along these lines, there is somewhat of a risk of the Consumer Challenge Panel starting with unrealistically high expectations of what its role should be and what it should achieve.

A Consumer Challenge Panel is not the solution to the problem of high network costs, but it could be an important part of the process for making network regulation and network businesses more responsive to consumer interests, so that consumers are more likely to be paying for the level of network service that they want.

However, there is an important question as to how much influence consumers can have on network costs through the AER price review process, which will depend upon the extent to which the regulator is working within constraints brought about by standards and legal requirements that have already been determined. For example, at present the state governments set reliability standards, that some commentators consider have not paid enough attention to consumer willingness to pay for those standards. COAG has recently agreed in principle to adopt a new best-practice framework for reliability standards that will take consumers’ interests into account and transfer reliability setting to the AER. A decision on implementation will be taken by the end of 2013 so at this stage the impact of this potential change is unknown.³⁹ It will also be the case that a significant proportion of network expenditure will be devoted to basic maintenance of the network. These factors also affect the degree of influence consumers can have in the UK. As Ofwat have noted “A large proportion of consumers’ bills is spent on maintaining current services or meeting legal requirements – for example, to protect the environment.”

Constraints on the scope for consumers to influence price setting are the reason that IPART is limiting consumer engagement to discretionary elements as noted above. Thus, for all forms of consumer engagement, it is important to be honest with consumers about where there is scope for them to influence and where there is not. For example, in the case of reliability standards, can consumers have a say in what the standards should be or is their scope for influence limited to efficient ways of meeting pre-set standards? It is likely that consumers would in fact have much more to contribute to the former (which is about choosing a level of reliability based on the

³⁷ COAG reaches agreement on electricity market reform. Joint statement from the Prime Minister, Deputy Prime Minister, Minister for Resources and Energy. Canberra, 07 December 2012.

³⁸ Alan Mitchell, Australian Financial Review, 05 Dec 2012.

³⁹ Council of Australian Governments Meeting – Communiqué Canberra, 7 December 2012

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costs of achieving it) than the latter (which is likely to involve more technical assessments of costs, benchmarking etc). As noted in the earlier section on DPCR5 in GB, the issue of consumer willingness to pay for particular levels of network reliability was an issue on which Ofgem conducted both consumer research and consulted the CC Group.

Another very important consideration is that there is no one “consumer interest” on any issue that the regulator has to take into account. Clearly, most consumers would prefer to pay as little as possible for their energy needs, but when it comes to what should be done or not be done as a means of keeping bills down, there will be many different options and consumers will have differing views on them. When choices offer the certainty of paying more in the next five years for the potential to reduce the risk of much greater costs in the future, consumer responses will vary according to their appetite for risk, discount rates etc.

It follows therefore, that it makes sense for the regulator to use a number of different means of consumer engagement to assess the consumer interest, so that it can “sense check” specific ideas. It is not likely to be a good idea to create a monopoly provider of the consumer view! So, for example, if the Consumer Challenge Panel is giving views that are very different from that obtained from market research (surveys, focus groups) and/or consumer organisations (including a new Consumer Advocacy Body if one is established), then the regulator will want to look carefully at why such differences may be occurring. There may be very good reasons for such differences, but this does mean that the regulator still retains its central role of balancing different interests and reaching judgements. Having a Consumer Challenge Panel or most other methods of consumer engagement (apart from negotiated settlement), does not imply “outsourcing” the job of the regulator to judge what will best serve the interests of consumers.

In terms of how the Panel operates, this is clearly for the AER to determine. However, some key issues to consider, based on the UK experience are as follows:

- It would be valuable for the Panel to have some interaction with other consumer organisations/advisory groups. This could also help to clarify the respective roles of different forms of consumer engagement in the process.
- Clarity about the respective roles of the panel and a new national energy consumer advocacy body (if one is established) will be important. It could be useful for the two bodies to agree a memorandum of understanding (MOU).
- It is reasonable to expect the Panel to provide some challenge directly to the network businesses through one or two meetings with them – ideally early in the process to allow the networks to incorporate this challenge in their proposals to the regulator.

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7. Conclusions

Given the limited nature of consumer engagement in network regulation to date in Australia, a Consumer Challenge Panel is likely to add something of value to the process. Key to its success will be getting people who have sufficient expertise and credibility with consumers and consumer organisations, resourcing them effectively and AER staff and Commissioners being committed to listening to their advice. This does not mean the AER has to accept all the advice – it is still the AER that makes the decisions – but it will need to be clear about why it has or has not taken it on board.

Equally important to recognise is that the Panel is only part of a consumer engagement strategy for the AER, that will also include consumer research, consultation processes with consumer organisations and individual consumers. It will also be important for the network companies to develop effective engagement with their consumers.