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Dear Sir / Madam

Response to consultation: "Collaboration between Economic Regulators"

Citizens Advice holds statutory responsibilities to represent energy and postal consumers in England and Wales in accordance with the Consumers, Estate Agents and Redress Act 2007.

This submission provides our response to the consultation on collaboration between economic regulators published on 6 October 2014. It is entirely non-confidential and may be published on your website.

We provide detailed comments on the questions posed in the consultation in the annex to this document, but before doing so wish to frame the context for this response and suggest a core area in which the Government needs to develop its thinking.

No-one currently holds responsibility for assessing the cumulative impact of infrastructure investment on consumers

The privatisation and liberalisation of UK utility sectors effectively shifted the burden of funding investment in those sectors from taxpayers to bill-payers. This has consequences both in terms of who pays, and who co-ordinates investment. The poorest in society tend to be far more exposed to costs under a bill-based approach, with consequential impacts on affordability[i].

At least two-thirds of the £310 billion of infrastructure investment contained within the National Infrastructure Plan is expected to be wholly financed, owned and operated by private companies – and will implicitly be bill based. This investment straddles multiple sectors and no-one is currently responsible for producing a cumulative picture. The National Audit Office (NAO) has been rightly critical of this:

‘No one in government is drawing together an overall forecast of consumer utility bills aggregated across the sectors. Consequently, each department could set policies and regulator set prices, believing them to be affordable, but consumers could still find the combined impact of all their bills rising simultaneously to be unaffordable. There is also no analysis of the overall affordability implications of rising bills for different consumer groups. Taken together with an understanding of other changes in living costs, this would help the government manage the impact for these groups.’[ii]

This information void is unsustainable: in order to deliver the desired outcomes or mitigate any adverse outcomes of policy proposals, Government requires a coherent understanding of the net winners and losers of its own decisions, and those made by its regulators. It needs to fully understand how different types of consumer are affected by infrastructure investment, and how this pattern will change over time. At the same time, given the long life of infrastructure assets, investors will only come forward if they consider public policies to be durable. If regulators and Government lack understanding of the cumulative burden that consumers’ face – of “how much is too much” as the NAO puts it - they run the risk of backlash and lack of public buy-in. This may increase the cost of infrastructure investment – or ultimately deter it.

We would strongly encourage the adoption of the NAO’s core recommendation that the Treasury should ensure it has mechanisms in place to understand the cumulative impact of infrastructure investment on consumer bills and its affordability implications, particularly for low-income households.

This will require the creation of a common framework for assessing the impacts of infrastructure investment across each sector, both so that this can inform the central forecasts created by Treasury and so that the outputs of its central forecasts can be fed back into sectoral decision-making – including by regulators. Clarity about whom the Treasury should be interacting with (i.e. who owns the job of conducting such analysis for each sector) is crucial.

It is unfeasible that such a framework could be put together without the involvement of the sector regulators as they play such a core role in determining infrastructure priorities. The UK Regulators Network (hereafter, “UKRN”) could play a crucial part in helping them to develop a common model.

Whose job is it to forecast future bills in any given sector?

There does not appear to be a clear consensus on whose role it is to assess the future impact of policy in bills in any individual sector – is it the regulator, the relevant government department or no-one?

For example, between 2009 and 2010 Ofgem conducted a forward-looking assessment of the future prospects for the UK hitting its decarbonisation targets and keeping the lights on; “Project Discovery”. Project Discovery included its assessment of the probable impact on bills in the period to 2020. While the Government welcomed the thoroughness of its assessment, Ministers indicated that they regarded this kind of forward looking assessment as “policy work” that should be conducted by the relevant government department, not the regulator[iii]. Since 2010, DECC has been producing regular forecasts of future energy bills and Ofgem has not attempted to replicate medium to long term price forecasting.

In respect of water however, the NAO report highlights that the limited forecasting of future bills that is done is attempted by the regulator, Ofwat (to the end of five year price control periods), not by DEFRA[iv]. In telecoms, neither the regulator nor the relevant government department is making such forecasts.

We are of the view that the absence of clarity on whether it is a departmental responsibility or a regulator’s responsibility to assess future bills within any sector may foster circumstances where either no long term bill forecasting takes place at all (as appears to be the case in water or telecoms) or where multiple long term forecasts exist (as was the case in energy around 2010). To avoid the risk of absence, duplication, or mutual inconsistency in forecasting, there is a need for a clearer steer from Government on where this responsibility lies and how it should be conducted.

Regardless of whether a view is taken that long term forecasting should sit with government departments or with regulators, the nature and scope of this forecasting should be centrally prescribed. This could be done by statute but may perhaps be more flexibly delivered through a detailed memorandum of understanding between the sector regulators (or government departments) that defines best practice in how it should be conducted. Such a tool may help to ensure that a central body, tasked with creating an economy-wide projection of future bill impacts based on these individual sector assessments, has access to mutually consistent data that it can use to build this picture[v].

Yours faithfully

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Annex – answers to consultation questions

Question 1: Do you have any views or experiences – on cooperation between regulators, particularly under the previous JRG regime and before the UKRN was established?

The JRG's impact on the UK regulatory landscape appears extremely limited; it was very low profile. For example, one of the authors of this response has worked in an economically regulated sector for over 12 years, including four years working for the regulator itself, and only became aware that the JRG existed when it was announced that it was being scrapped and replaced. We are not aware of the work of the JRG having had a material impact on any decision in any regulated sector at any time.

The JRG had no budget, staff, statutory powers or presence. The UKRN appears weightier, though still limited. While it still lacks statutory powers or remit, it appears to have more buy-in from the regulators and more of a public presence. Its budget and staffing appears currently limited to a small secretariat with the bulk of its output provided by virtual teams working within the regulators themselves. Its outputs are not binding on its members, and cannot supersede their existing statutory duties. Its ability to deliver therefore appears heavily contingent on continued goodwill and commitment from each of the economic regulators. It is too early to say whether this will exist.

Because of its voluntary nature and lack of statutory footing, there is a risk that the UKRN could simply become a vehicle for studies that are of only limited cross-sectoral interest, or that the regulators would simply have conducted anyway on their own. It should be stressed that this is simply a risk, not a probability – it has not yet had time to prove (or disprove) its worth.

An issue that will face UKRN and its member regulators under any of the three options you propose is that regardless of how well they cooperate, their underlying statutory duties will not alter. It will still be the responsibility of the energy regulator to represent energy customers, of the water regulator to represent water customers, and so on. This may mean that cross sector investments that make sense to the UK at aggregate level still continue to fail to be approvable by individual regulators.

For example, let us assume for the sake of argument that the roll-out of smart metering and that the roll-out of high-speed broadband could have some synergies – because one mechanism of communicating with smart metering and smart devices in the home may be via broadband. If this proposition is true, it may be that co-ordinating investments across the energy and telecoms sectors would be in the public interest. Co-operation between the regulators, whether voluntary (under option 1), encouraged (under option 2) or required (under option 3) may help the two regulators to identify that such synergies exist. But they will not change the fact that each is bound to only direct changes to their industry rules if doing so is in accordance with their individual statutory duties. These may mean they cannot take into account benefits (or detriments) resulting from the knock-on effects of their decisions outside their sector. This could create circumstances where an investment that, in the round, helps consumers still being rejected because it cannot pay for itself within a single sector.

Question 2: Are there any specific areas where cooperation amongst the regulators could bring greater benefits and/or protections for consumers? Please provide any examples that you think will help demonstrate your argument.

One can see areas where infrastructure investments may naturally straddle multiple sectors. For example (and this is by no means an exhaustive list):

- The communications infrastructure used/developed for smart metering. The former is regulated by Ofcom, the latter by Ofgem. In principle, the architecture and systems created could provide a basis for water metering too, regulated by Ofwat. Consumer rights in relation to smart goods in the home may be governed by the Office of Fair Trading.
- While classifications of vulnerability differ between sectors, there are likely to be many instances where a consumer is classed as being vulnerable in many sectors. Delivering support to these consumers may be more cost effective if joined-up. For example, could there be a joint Priority Service Register for both energy and water?
- Constructing network price controls for monopoly utilities is a thematic area of work carried out by several of the named regulators. As far as we are aware, all UK utility regulators apply some variant of the CAPM methodology. Cooperation in this area could reduce duplication in supporting work and increase cross-sectoral consistency, though it should be noted that a one-size-fits-all approach would remove some positive tensions that can arise from regulators competing with each other, for example in relation to testing and driving down the Weighted Average Cost of Capital awarded to monopolies[vi].
- No-one currently holds responsibility for assessing the cumulative impact of infrastructure investment on consumers. Therefore, none of the regulators is in any real position to make a judgement on "how much is too much" or how to prioritise spend between sectors if not everything in the infrastructure pipeline is affordable. Co-operation between the regulators could help to build this picture, resulting in both individually and mutually better informed policy.

Questions 3, 4 and 5: Is there evidence of areas where sharing best practice and developing more consistency between sectors would benefit investors, regulated companies and/or consumers? Are there specific areas where better cross-regulator cooperation could improve infrastructure delivery or incentivise the more efficient use of infrastructure assets or networks? Do you believe that Government should take further steps to support and encourage cooperation between regulators? If so, what would be your favoured approach and what benefits do you think this would bring?

Please see our introductory remarks to this letter. At present, no-one is responsible for assessing the cumulative impact of investment in economically regulated sectors on consumers. In some cases, even within-sector analysis is weak. In the absence of credible cumulative forecasts, it is highly likely that policymakers will fail to identify:

- Synergies between investments in different sectors – instances where co-ordinating spend or streamlining processes results in higher overall benefits to consumers;
- The overall pattern of “winners and losers” amongst consumers – and therefore any need to take mitigating action to help the worst affected; and
- How they should prioritise spend. Not everything in the UK’s infrastructure pipeline may be affordable. If it is not, what has to give way? The current framework fails to provide a diagnostic tool to work this out.

For balance, we do see some evidence of best practice being shared even under current arrangements. The relatively transparent nature of the UK regulatory regime combined with the churn of staff over time between regulators has resulted in a steady diffusion of practices between them; in particular, there are often considerable similarities in the way that different regulators approach thematically similar issues like price controls. But it appears to us that this has largely resulted from the organic development of UK regulatory philosophy rather than a specific mechanism that encourages or forces the regulators to cooperate (because none has existed). Put more simply: we think best practice (and in some cases, bad practice) has been shared across regulators unconsciously, rather than by design.

Question 6: Do you have any views on the advantages and/or disadvantages of each of the three options identified? Do you have a preferred option?

<u>Option 1: Monitor progress and work with the UKRN</u>

We interpret Option 1 as a close to, if not quite, “do nothing” option.

The main advantage of this approach is that it mitigates the risk of unintended consequences. The UKRN has only existed for a few months and has yet to deliver many products. There is insufficient evidence at this time to reach a firm view that it is either capable, or incapable, of delivering improved cooperation between the economic regulators. A monitoring approach would buy time to judge its operational performance in practice and to subsequently act in accordance with that evidence at a later stage. Option 1 would avoid the need for legislation inherent in Option 3 and therefore the uncertainty that it could create while it passes through the parliamentary process.

Disadvantages of this approach include that it may foster inertia and lack transparency. As a stakeholder, the relationship between Government and the regulators is often quite opaque to us. There is a lack of detail in the consultation to give us confidence that this would change. In the absence of this, stakeholders may have no way of knowing whether the Government considers that the new arrangements are working or not, how they could provide feedback on whether they shared that view, or even when (and how) such an assessment would be made.

<u>Option 2: Guidance on cooperation</u>

The advantages of this approach are limited in our view, but are that it could provide a prompt for the regulator to consider wider issues outside their sector when reaching a decision, or seeking evidence, for a decision within their sector. By extension, it could also provide a reference tool for stakeholders to prompt the regulator(s) that they need to do so.

The disadvantages of this approach are that it is more burdensome than do nothing, but may achieve little. Guidance has no legally binding effect; it may simply be ignored. It may also be hard to produce a single piece of meaningful guidance that can cover nine different regulated sectors and be flexible enough to adapt to their changing circumstances.

There is a precedent for the Government providing guidance to specific regulators on how they should carry out their duties, for example in the energy sector the Gas and Electricity Acts (as amended) allow for the Secretary of State to provide guidance on social and environmental matters. Our perception is that these guidance tools have had limited effect. While the principles they have set out have been laudable, they have also tended to be both high level and self-evident. The guidance is rarely explicitly referred to in regulatory decisions.

Option 3: Statutory duty to cooperate

In principle, the main advantage of this approach is that it cannot be ignored. Regulators would be legally compelled to comply with the statutory duty. Exactly what it compels them to do, and how they would demonstrate that they have delivered this in practice, would depend on how it was worded. Insofar as it increases cooperation, it should improve consumer (and investor) outcomes. This benefit is hard to quantify, but could be substantive.

There are several possible disadvantages to this approach. One is that, if clumsily worded, it may increase bureaucracy if it compels regulators to demonstrate that they have cooperated with each other on issues where the benefit of such cooperation is limited or nil. This could slow down decision making and/or increase its costs.

A second potential disadvantage is that it could increase the judicial review risk faced by regulatory decisions. It creates another set of procedural hurdles that regulators will need to pass in order to have reached a legally defensible position. Regulators may legitimately disagree on the way forward on any matter, and this may create grey areas on whether this statutory duty has been adequately met. For example, if two regulators strongly disagree does this suggest that they are not cooperating (because of the disagreement) or that they are (because they are talking)?

Advantages and disadvantages that are common to all three options

A common disadvantage to all three options is that a duty to cooperate does not remove the pre-existing statutory responsibilities for regulators to only have regard to the impact of decisions on consumers and participants in the individual sector that they regulate. This may mean that decisions that are in the public interest cannot be made – for example, if an investment fails an individual regulator’s statutory duties despite providing a net benefit when its impact across multiple sectors (and regulators) is taken into account.

Preferred option

Of the three options on the table, our preferred option would be Option 1: Monitor progress and work with UKRN. This is because it appears reasonable to give the UKRN time to find its feet before reaching a judgement that it is (or is not) up to the task of encouraging regulatory cooperation. It creates fewer legal risks than Option 3. We have no objection to Option 2, but nor do we find it persuasive that it would meaningfully alter the level and nature of regulatory cooperation.

As previously highlighted, a core responsibility that the Government needs to deliver is a framework for assessing the cumulative impact of infrastructure investment on consumers. We think the overarching responsibility for this must rest with Government but that in order to do so it will need to know the picture in individual sectors in order to build this overall picture. The regulators have a part to play in providing those building blocks – and in acting on the overall findings (for example, by bringing forward or pushing back costs in their sectors to smooth out the overall picture, or in providing targeted support for the worst affected). Whichever option it takes forward, we will look to BIS to provide evidence that the new framework will help to deliver this.

Question 7: What are your views on how best to implement each of the three options identified without becoming overly burdensome or impacting regulatory stability?

Option 1: Monitor progress and work with the UKRN

If this option were preferred, we would wish to see a detailed plan setting out how you will measure, and report on, the effectiveness (or not) of the UKRN regime. This would need to include the creation of clear criteria against which its effectiveness could be judged. We would be looking for evidence that UKRN products:

(a) would not been produced by the regulators anyway (that the UKRN is not simply a white-label brand for business-as-usual work); *and*
(b) are adopted in regulatory decisions (that there is a visible breadcrumb trail between research created and individual regulators subsequent decisions); *and*
(c) result in better consumer outcomes.

As highlighted repeatedly in this submission, we believe a core aim of the UKRN must be to build up and maintain a coherent picture of the cross-economy winners and losers from current and projected infrastructure spend, and to act accordingly to prioritise spend and provide mitigation to the worst affected.

Option 2: Guidance on cooperation

Providing a single piece of guidance that is relevant to all nine regulators that is neither so high level as to be meaningless nor so project specific as to become rapidly outdated appears highly difficult. We can offer no advice on how this could be achieved – or, indeed, if this could be achieved.

Option 3: Statutory duty to cooperate

We note, and oppose, the suggestion in paragraph 3.17 that any statutory duty to cooperate would be limited to economic regulation functions. This is unjustified in principle and unworkable in practice.

Statutory duties vary between regulators, but often also include social and environmental duties (for example, the protection of defined groups of vulnerable customers). We see no reason why cooperation in these areas should be considered less valid and valued than cooperation on economic regulation issues.

Restricting the duty to cooperate could create conflict within the statutory hierarchy in one or more sectors. For example, Ofgem's duty to protect consumers is part of its primary statutory duty while some of its economic duties are covered by its secondary duties. If it were given a responsibility to cooperate with other regulators on the latter, but not the former, this would appear to imply that its secondary duties were regarded as more important than its primary duty. This would be illogical.

More broadly, if you constrain the duty to cooperate to economic regulation functions you create the thorny problem of defining exactly what those are. Many regulatory decisions straddle the boundaries between the social, the environmental and the economic. Reaching a legally robust definition could be very difficult and any ambiguity exacerbates the risk of legal challenge on any controversial and/or high materiality decision.

For those reasons, we think that any legal duty to cooperate should allow regulators to do so in any area that is relevant to the delivery of their duties, and not simply constrained to economic issues.

The consultation identifies nine different regulators to whom a statutory duty to cooperate could be applied. On a case-by-case basis the value to consumers and society in them co-operating may vary. For example, the energy regulator may wish to cooperate with the water regulator (but not the financial regulator) when developing a regime to encourage efficiency in digging up the roads to install pipes and wires, while conversely it may wish to cooperate with the financial regulator (but not the water regulator) when looking at monitoring potential market abuse in energy trading. It would therefore be important that any statutory duty to cooperate was framed in such a way that it only necessitated regulators cooperate with other designated regulators where it is *relevant* to the decision at hand, recognising that this may vary from case to case.

It would also be important that any statutory duty to cooperate was clear on the extent to which legitimate disagreement between regulators is permissible. There may be instances where two or more regulators individually acting in a reasonable manner simply cannot agree. This could be because the facts are not in dispute, but statutory duties are in conflict (for example, that a shared infrastructure project makes sense on a standalone basis in one sector but not in another – resulting in a decision to approve it being consistent with the statutory duties of one but not the other). Or it could be because legitimately different interpretations are possible; not all decisions are black-and-white. We would be worried if anxiety that such differences could be interpreted as a failure to cooperate created judicial review risk that discouraged regulators from taking decisions where consensus could not be reached.

Question 8: Are there any other options which the Government has not identified in paragraph 3.3. If you identify any, what are the advantages and disadvantages of such options?

Yes, there are several other options.

One would be the adoption of a cross sector utility regulation model. Rather than having one regulator per sector, have a single regulator that covers multiple (or all) sectors. This body could be given statutory duties to co-ordinate investment across sectors to maximise the public benefit. This approach would reduce the inefficiencies involved in having multiple bodies separately carrying out fundamentally similar duties (as currently happens in the area of setting price controls); remove the problems that a single-sector regulator would face in considering a decision that facilitates the wider public interest but fails its own statutory duties; and allow for joined up impact assessments. This model has been adopted successfully in many countries and would wholly remove the barrier to cooperation that you are seeking to tackle through this consultation. Collapsing a number of regulators into a single regulator would not be risk free however. It would represent a substantive change from the status quo with associated transition risks and costs. It would remove the arguably healthy competitive tension than can exist with separate regulators trying different approaches to similar issues; the learning that this exposes would be lost. It would also create wider systemic issues if the regulator was not very good at its job – as all eggs are now in one basket.

An alternative to giving individual regulators a duty to cooperate could be to give them a duty to take into account any wider benefits (or detriment) that consumers could suffer in another sector as a result of a decision in that sector. In effect, to say that these externalities are explicitly relevant to their decision and can therefore be legitimately taken into account in reaching a decision (currently they are not, and cannot be). The intention here would be to allow an individual regulator to bring forward (or push back) investments or decisions in its sector, or tailor processes differently than it might do if only its own sector was relevant, if so doing created benefits for consumers in another sector. Defining this duty could be every bit as problematic as defining a duty to cooperate would be. If sloppily framed, it could create dispute as to whether regulators have fully identified impacts that are outside their sector and direct field of expertise. But it would remove the tension inherent in current sector-specific statutory duties whereby non-sector benefits (or detriment) must be deemed irrelevant to the regulator's considerations.

One operational step that regulators could take to demonstrate cooperation is joint impact assessment of major cross-sector issues. Current legislative requirements to conduct impact assessments in defined circumstances, such as those in section 6 of the Sustainable Energy Act 2003, do not require cross-sector impacts to be considered – but nor do they appear to preclude them from being considered. Where legislation is silent, there may be scope for regulators to try to develop joint documentation and assessments – even if their subsequent decisions must be made on a standalone basis according to their individual statutory duties.

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[i] This point is commonly accepted. For example, in its 2013 report on energy prices, profits & poverty the Energy & Climate Change Committee noted that 'the increasing use of levies on bills to fund energy and climate change policies is problematic since it is likely to hit hardest those least able to pay.'

[ii] "Infrastructure investment: the impact on consumer bills," National Audit Office, 13 November 2013. http://tinyurl.com/o4b2rgx

[iii] For example, Utility Week reported on 17 June 2010 that speaking at a Nuclear Industry Forum, (then) Minister for Energy Charles Hendry MP *'praised the thoroughness of Ofgem's "Project Discovery" assessment, but said that policy work should be done by the Department for Energy and Climate Change'*.

[iv] See figure 8, page 27 of the NAO report.

[v] The absence of such data appears to have hamstrung previous attempts to create central economy-wide forecasts; the NAO's report suggests that Infrastructure UK appears to have considered but then abandoned such analyses in the past as either "not feasible" or likely to become outdated by policy developments. Our own attempts to forecast economy-wide infrastructure burdens on consumers have also been hampered by the absence of credible, mutually consistent data that we could use.

[vi] For example, in their current price control determinations, Ofwat and Ofgem are proposing different costs of equity: 5.65% for the former, 6.00% for the latter. Even small incremental decreases can result in very material consumer savings – though at the risk of discouraging investment. Competition between regulators can help to explore these tensions.