



# The Customer Forum: Customer engagement in the Scottish water sector<sup>☆</sup>



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## ABSTRACT

The Customer Forum was set up in 2011 to carry out customer research, represent the interests of customers to Scottish Water and the economic regulator WICS, and to seek to agree a business plan with the company. It was set up with the agreement of all parties. The aims were to improve on previous price control approach, to find a new way of challenging the company and to bring greater customer input to bear. The constitution, expectations and timetable of the Forum were specified in some detail. WICS also provided many Guidance Notes about its own expectations. Financial tramlines were established to monitor performance during the forthcoming price control period. The process worked well, all parties worked constructively and agreement was reached on a business plan upon which the regulator subsequently proposed a price control. There is scope to apply the process in future and in other sectors.

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## 1. Introduction

The Customer Forum was set up in September 2011 with three aims: to work with Scottish Water on a programme of customer research; in the light of this to understand and represent customer priorities to Scottish Water and to the Water Industry Commission for Scotland (WICS); and to seek to secure the most appropriate outcome for customers in the Strategic Review of Charges. In October 2012 the Forum was additionally asked to seek to agree a Business Plan with Scottish Water, consistent with Ministerial Objectives and with guidance notes that WICS would provide. At the end of the engagement process, Scottish Water and the Forum would prepare a document (or documents) setting out the extent to which they agreed or disagreed. WICS would take these documents

into account in its Draft Determination, which would propose Scottish Water's charges for the period 2015–2021.

In January 2014, the Customer Forum and Scottish Water did reach agreement on a Business Plan. In March 2014 WICS made a Draft Determination consistent with that Business Plan. All representations in the subsequent consultation were supportive, and a Final Determination in similar vein is expected in early November.

This paper provides an account of why and how the Forum was created, how it went about its tasks and with what success, what roles the regulator WICS and the regulated company Scottish Water played, what problems were encountered and how they were addressed. It tries to assess what difference the Forum process made, what made it work and whether public ownership of Scottish Water was significant. Finally it considers what in retrospect might have been done differently and what might be done in future, particularly with respect to the statutory and regulatory context.

I must explain my own involvement in this process. In late 2010 I had half a dozen meetings with WICS and other parties to explain the nature of customer engagement in other jurisdictions and to discuss setting up the Forum. In November 2011 I met with the newly appointed Chair of the Forum to explain the nature of customer engagement elsewhere. At end 2012 and early 2013, I was asked to conduct a series of interviews with the participants on an approximately quarterly basis, so as to give a picture of how the Customer Forum had gone about its work through to the Final Determination. These interviews provided continually fascinating and informative insights. In my view, the Customer Forum process

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<sup>1</sup> As explained herein, I advised WICS in relation to setting up the Customer Forum project. WICS provided financial support for the series of interviews referred to in this paper, and for preparation of this paper. I am grateful to Suzanna Wolstenholme of Shepherd & Wedderburn LLP for organising and transcribing the interviews and liaising with participants; and to the interviewees for their time and thoughtful comments. Although I have drawn (anonymously) upon the interviews here, the participants should not be held responsible for views expressed in this paper. I am also grateful to a reviewer for considered and informed comments and suggestions.

has been one of the most innovative, successful and encouraging developments in UK utility regulation.

These interview transcripts are in process of being made available to other researchers in order to provide a fuller and independent account of the Customer Forum process as seen through the eyes of the participants themselves, illustrating their evolving expectations, hopes and fears as reflected in the interviews they gave. In the meantime, it is hoped that the present paper will alert a wider audience to the Customer Forum approach, and provide an incentive for practitioners and researchers to explore further its possible implications and applications. The paper has drawn upon the various publications of WICS, Scottish Water and the Customer Forum referenced herein, as well as the interviews mentioned. It has been shown to all the participants in the process and has sought to address any factual inaccuracies or misrepresentations that they made known to me.

## 2. Statutory background (see also Glossary)

Scottish Water, created in 2002 by the merger of three previous entities, is the publicly-owned water and sewerage company in Scotland. Initially it was regulated by the Water Industry Commissioner, which was succeeded in 2005 by the Water Industry Commission for Scotland (WICS), the economic regulator for the Scottish water sector, with a statutory duty to promote the interests of customers. WICS has the function of determining maximum amounts of charges for services provided by Scottish Water by such time and in respect of such period as Scottish Ministers may specify.

The process by which WICS discharges this function is known as the Strategic Review of Charges. These charges have to be sufficient to cover Scottish Water's cost of meeting the Ministerial Objectives set for it "at the lowest reasonable overall cost". They must also give effect to Scottish Ministers' Statement of Policy regarding charges.

Before setting the Ministerial Objectives or issuing the Statement of Policy, Scottish Ministers must consult Consumer Focus Scotland (CFS), which at the time of establishing the Customer Forum was part of the National Consumer Council. Throughout this period, the arrangements for customer representation were evolving.<sup>2</sup> Other bodies whose roles impact on economic regulation of the Scottish water sector include the Scottish Environment Protection Agency (SEPA) and the Drinking Water Quality Regulator (DWQR).

## 3. The need for a change of regulatory approach

Government evidently plays an explicit part in a Strategic Review of Charges, which is not the case in price control reviews in England and Wales. Nonetheless, in the past WICS made similar use of benchmarking against English companies as Ofwat did.

The outcomes of successive WICS Final Determinations would seem to have been increasingly satisfactory. Whereas the 2002–06 review proposed an increase in charges totalling nearly 20% in actual terms, 8.4% in real terms, the 2006–10 review proposed an annual reduction in charges of 1.5% per year in real terms, and the 2010–15 review proposed price changes 5% below the rate of

inflation. In parallel, WICS reported increased efficiency, good investment and improvements in customer service. What then was the pressure to change the regulatory approach underlying the 2015–20 Strategic Review?

WICS had several motivating factors: it felt that, with Scottish Water's improved efficiency, benchmarking against English companies had run its course; it was uncomfortable with Scottish Water's previous use of customer consultation but felt unable to challenge this; and it wished to do something to legitimise household bills in the eyes of customers. Economic conditions had declined since the financial crisis, and there were concerns that Government might intervene if the outcome of the next Review was seen as burdensome on consumers. WICS considered various possibilities of increasing competitive pressures to address these issues – for example, by extending retail competition to the household sector or by restructuring (disaggregating) the industry – but considered these would be difficult.

Independently of the above factors, WICS had a concern about how to discharge its statutory remit to determine "the lowest reasonable overall cost". There were different ways of achieving Ministerial objectives with different degrees of certainty, and there were options about when and how far the objectives should be achieved. There were not objective answers to these questions, so determining "reasonable" involved a judgement call. This in turn seemed to require input reflecting the views and preferences of customers. WICS did not feel that it was well-placed itself to make the trade-offs involved.

In sum, WICS felt the need for a new way of challenging Scottish Water and also the need for more customer input into the decision-making process. It was therefore looking for a new approach that met these two needs.

In July 2008 WICS became aware of my articles on negotiated settlements in the United States and Canada. These also mentioned constructive engagement used by the CAA in regulating the UK airport sector and suggested the possibility of applying such approaches in the UK water sector.<sup>3</sup> In March 2009 both WICS and Scottish Water attended a conference in London on this topic.<sup>4</sup> In September 2010 WICS participated in a briefing that Catherine

<sup>3</sup> These papers were subsequently published as "Negotiated settlements: the development of legal and economic thinking" (with Joseph Doucet), *Utilities Policy* 14, December 2006, 266–277. "Let's talk", *Utility Week*, 2 May 2008. "Constructive engagement and negotiated settlements – a prospect in the England and Wales water sector?" 29 August 2008. "Lets make a deal ...", *Utility Week*, 14 November 2008. "Stipulated settlements, the consumer advocate and utility regulation in Florida", *Journal of Regulatory Economics* 35(1), February 2009, 96–109. "The bird in hand: stipulated settlements in Florida electricity regulation", *Utilities Policy*, 17 (3–4), September–December 2009, 276–287. "Negotiated settlements and the National Energy Board in Canada", (with Joseph Doucet) *Energy Policy*, 37, November 2009, 4633–4644. "Planning, competition and cooperation: the scope for negotiated settlements", in Dipak Basu (ed.), *Advances in Development Economics*, World Scientific Publishing Co. Pte. Ltd, 2009, 119–124. See also "The process of negotiating settlements at FERC", *Energy Policy*, 50, November 2012: 174–191.

<sup>4</sup> SGBI conference, held in London on 5 March 2009, on the theme *After RPI-X: What Next?* Speakers and attendees included the CEOs of Ofgem, Ofwat and WICS and senior figures in UK regulatory bodies and regulated companies (including Scottish Water's General Manager Regulation). Speakers on customer engagement, who also participated in discussion at the dinner preceding the conference, included Nick Fincham (CAA) on Negotiation in UK airports price regulation, Kenneth Bateman (NEB) on Negotiated settlements in Canada, Scott Thomson (Terasen Gas, Canada) on Negotiated settlements from the perspective of a local distribution company, Jack Shreve (former Public Counsel – a Consumer Advocate - in Florida) on Regulation without regulators: delivering equity for all, and Tony Ballance (Severn Trent) on Could constructive engagement work for the water sector? I chaired the dinner discussion – a dinner which Alan Sutherland (CEO of WICS) said in interview was very useful to WICS - and at the end of the conference gave some final remarks on Key issues and conclusions.

<sup>2</sup> Waterwatch Scotland was established in 2002 with a duty to represent customers, investigate complaints and influence policy. It was abolished on 15 August 2011 and its functions passed to the Scottish Public Services Ombudsman and CFS. In April 2013 Consumer Focus became Consumer Futures and CFS's responsibility for representing consumers' interests was transferred to Citizens Advice Scotland, except in energy, post and water. CFS was finally abolished on 31 March 2014, and Consumer Futures became part of the Citizens Advice service. For simplicity of exposition, this paper uses the term Consumer Focus Scotland (or CFS) throughout the period 2011 to date.

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