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Published in:
Water Policy : Official Journal of the World Water Council

DOI:
[10.2166/wp.2016.199](https://doi.org/10.2166/wp.2016.199)

Publication date:
2016

Document Version
Peer reviewed version

[Link to publication in Discovery Research Portal](#)

Citation for published version (APA):
Hendry, S. (2016). The Customer Forum: putting customers at the centre of regulating water services . *Water Policy : Official Journal of the World Water Council*, 18(4), 948-963. <https://doi.org/10.2166/wp.2016.199>

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The Customer Forum – Putting Customers at the Centre of Regulating Water Services

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Abstract:

This article will explore recent initiatives in customer engagement in water services in Scotland, UK. Scotland has a well-established and successful model for water services regulation and governance, with a public supplier performing as efficiently as the top quartile of private English companies. One recent innovation has been a form of negotiated settlement between the provider and a group representing customers, as part of the price setting process. The paper will assess the initial intention and the subsequent evolution of this initiative, arguing that such developments can work well, when conditions are right. Enabling conditions may include a surrounding regulatory structure that is sufficiently mature and performing sufficiently well. It will offer some reflections on the process and on the role of such a body in the future, and will also posit that there are features of public sector providers that may make these more, rather than less, conducive to efficient and effective service delivery in the customer interest.

Key words:

Water services regulation, economic regulation, customer engagement, price setting, public sector efficiency, negotiated settlements

1. Introduction

¹ My thanks to those who have read and commented on drafts of this paper, including the anonymous reviewers. Any errors or misconceptions of course remain my own.

The regulation of water services is of interest to service providers, policymakers, economists and lawyers, and of course to water users – the customers or potential customers of the service, as well as those who compete with them for access to the resource. ‘Economic regulation’ can be construed narrowly, to relate only to the prices charged for the services provided, or more broadly, to include aspects of environmental compliance, and social tariffs for the poor and unserved. This paper will take that broader view, for both environmental and social factors are essential to developing appropriate service standards for the benefit of all customers, existing and future. Whilst in the past economic regulation was seen as necessary for the private sector, there is also (and increasingly) recognition of the necessity of regulating the public sector (see, e.g. World Bank, 2004; OECD, 2011). This is true in other networked industries that are natural monopolies, but perhaps especially for water, as most water services continue to be delivered, or have assets owned, by public authorities. Further, in recent times there has been a new focus on governance, as well as regulation, of water services and again, this is pertinent to the public and private sectors (OECD, 2015). As part of that governance agenda, there is a pressing need to engage better with customers of the service, especially in terms of price setting, standards, and the trade-offs between these; these questions arise in both developed and developing countries. This paper will examine recent innovations in Scotland, which is part of the UK but has separate provision for water services and where the economic regulator, working with the service provider and other regulators, established a new body, the Customer Forum, to represent customers in the price setting process, during the 2015 strategic review of charges. The Forum evolved to become a negotiating body, effectively agreeing a business plan with the service provider. That evolution will be discussed below, suggesting ways in which the experience in Scotland might provide a useful example to other places seeking to enhance the role of customers, and drawing comparisons with England, which has a similar regulatory model but a different ownership structure. The paper’s author was a member of the Forum and will therefore be able to combine academic analysis with an experiential understanding of the process. For this reason the paper will occasionally use the first person. It should be noted that others are producing reviews

of the work of the Forum, from different perspectives. This includes other academic analysis (Littlechild, 2014); and also a 'legacy report' produced by the Forum itself (Customer Forum, 2015). Much general background and detailed discussion can be gleaned from these documents. This article will focus on the regulatory and governance initiative in a comparative context, giving some personal views as a Forum member but also drawing on other work in regulation of water services and suggesting ways in which the process might – or might not – be of interest to others.

2. The Regulatory Model and Ownership Structure of Water Services in Scotland

Scotland's water services industry has a similar regulatory model, but a very different ownership structure, from that in England, where services were divested in the 1980s to form a series of vertically integrated regional monopolies² (Bakker, 2003). These were and are subject to price cap regulation (Ogus, 1994); but in recent years the system has been perceived as burdensome for both regulated and regulator, and attempts have been made to lessen this in the most recent (2014) periodic review of prices (Cave, 2009). The 'English model' of full divestiture is well known, though it is not the most widely used form of private sector participation for water; it was applied to utilities throughout the UK, but divestiture did not take place for water in Scotland (Hendry, 2003).

Scotland's water services were delivered by regional authorities until 1996, then by three appointed regional water boards, and since 2003, by a single public corporation, 'Scottish Water'.³ The move from municipal provision to separate water entities has been a feature of reforms of the delivery of water services in many countries and was an important part of the development of the regulatory model in Scotland. It required – and enabled - much better accounting separation. The 'commercialisation' or 'corporatisation' of water services is sometimes controversial, as it may be seen as a precursor to 'privatisation' (see for example McDonald and Ruiters 2005) and of course

² Water Act (UK) 1989 c.15.

³ Water Industry (Scotland) Act 2002 asp.3 (WISA).

this may be the case. However, accounting separation of complex and capital-intensive services is a useful activity in itself, enabling better understanding of the costs of delivery over time and aiding transparency and accountability. This happens, for example, in municipal service provision above a certain threshold in Australian states.⁴ Such financial clarity is beneficial, whether or not the service remains with a municipality, is transferred to a specific public sector vehicle, or is to be subject to private sector participation.

Scottish Water is a vertically integrated supplier, managing the whole supply chain from catchment to sea and serving almost all of the population with water and wastewater services. As a public corporation it is essentially owned by the Scottish Government, and the Government issues both policy objectives (Scottish Government, 2014) and a set of 'principles of charging' (Scottish Government, 2014a). The objectives are issued in the form of Directions and are binding on the regulators.⁵

Within that policy framework, Scottish Water has four main regulators. The Water Industry Commission for Scotland (WICS) was established in 2006 and is the economic regulator.⁶ Unusually for the public sector, the WICS is not merely an advisory body but determines charges within each review period (currently, every six years). There is a Drinking Water Quality Regulator, which monitors and enforces standards for public supply (by Scottish Water) and oversees the management of private supply.⁷ The environmental regulator is the Scottish Environment Protection Agency, which licences abstractions and discharges and also leads the river basin planning process

⁴ See, e.g., in Queensland, Local Government (Qld) Act 2009 No.17; Local Government Regulation 2012 SL No.236.

⁵ WISA s.56A.

⁶ Under the Water Services (Scotland) Act 2005 asp.3 (2005 Act). Prior to that, from 1999-2006 there was a single Commissioner, who advised Government on prices.

⁷ Also under the Water Services (Scotland) Act 2005. Private supplies would include individual and community schemes beyond the limits of Scottish Water's networks.

under the EU Water Framework Directive (WFD; European Commission, 2000). As a vertically integrated supplier, Scottish Water is a major stakeholder in river basin planning and carries out measures under the river basin plans, which contribute to environmental improvements and other public goods such as flood defence, carbon reduction and biodiversity. All of these activities are part of the regulatory settlement and charges are set accordingly. The final regulator is responsible for consumer advocacy and that role is currently exercised by Citizens' Advice Scotland, in a complex and rapidly changing environment (see section 4 below).

Scottish Water's activities are funded by charges which are broadly cost-reflective within each of household and business customers, and government borrowing, currently around £120m / annum. Their capital programme amounts to around £500m / annum. There is some cross-subsidy, especially between urban and rural customers. The Government operates a 'Quality and Standards' process, by which all the regulators and the Government agree the technical detail of Scottish Water's investment programme. In essence, Scottish Water develops a draft business plan, containing their proposals for the next strategic review period. The WICS assesses this in the light of the ongoing reporting which they (and other regulators) require from Scottish Water, and then issues a draft determination, which is put out to consultation – to the Ministers, Scottish Water and the customer representatives, and also published for public comment.⁸ The Commission must have regard to any directions or other guidance issued by the Ministers.⁹ Once the determination is finalised, Scottish Water have the right to appeal, to the (UK) Competition and Markets Authority.¹⁰ Otherwise, the determination will apply through that pricing period. There is the possibility of an

⁸ WISA s.29B

⁹ WISA s.29C

¹⁰ Water Services etc. (Scotland) Act 2005 (Consequential Provisions and Modifications) Order 2005/3172 (a Westminster order, as it is a reserved function).

‘interim determination’ if circumstances change outwith Scottish Water’s control (for example, new legislation or some other ‘external shock’),¹¹ and the WICS may request Scottish Water to so apply.

Scottish Water will finalise its business plan, and then issue a charging scheme annually, within the overall settlement, and the WICS will approve that yearly (and may modify it, with reasons).¹² The charging scheme must enable Scottish Water to provide its core services ‘effectively’ and comply with any policy statement.¹³ Effective exercise of core functions is then defined as complying with the objectives in the Directions, at the ‘lowest reasonable overall cost’.¹⁴

Although Scottish Water is a public entity, there is some private sector participation in the sector in Scotland. This includes elements of Scottish Water’s supply chain, but also some wastewater Public-Private-Partnership (PPP) schemes introduced in the 1990s, and more recently some retail competition. The PPP schemes used Build-Own-Operate contracts with engineering consortia, to construct plant to meet EU urban water treatment standards (European Commission 1991), but led both to very large end-of-pipe solutions and to lifecycle costs well in excess of public borrowing for new plant (albeit off the public balance sheet). These contracts will soon be at an end and this approach will not be used again in water in Scotland, although similar PPP schemes have been widely used in the UK, for example in transport, for schools and hospitals.

The retail market is more relevant to current policy developments. A decision was made to open the market, for business customers only, and for retail services only (Hendry 2008).¹⁵ Licensed providers

¹¹ WISA s.29F

¹² WISA s.29A

¹³ WISA s.29C

¹⁴ WISA s.29G

¹⁵ Under the Water Services (Scotland) Act 2005. England is currently opening their retail markets under a much more ambitious scheme under the Water Act 2014, which will have consequences for Scotland which are beyond the scope of this paper.

of retail services are licensed and regulated by WICS. Scottish Water was required to separate out and ring-fence their own retail activities (into 'Scottish Water Business Stream'); most other licensees come from the English water utilities. Although relatively small numbers of business customers transferred, the WICS' view is that the existence of competition has improved the efficiency of Business Stream (WICS, 2013).¹⁶ Licensed providers can rationalise billing for entities with multiple sites, and offer water efficiency advice. They are prohibited (as are all persons or entities except Scottish Water) from putting water into the public system, or taking wastewater out.¹⁷ Importantly, Scottish Water publishes its wholesale price to the retailers, so there is a high degree of transparency. The position of business customers was recognised as relevant to the work of the Forum and the legacy report notes that business customers need to be represented more effectively, not just in any future Forum but also in relation to Scottish Water generally (Customer Forum 2015). Because customers have contracts with the licensed providers, Scottish Water may take the view that they do not have a direct relationship with those customers. Nonetheless Scottish Water provides the wholesale service and connection to the infrastructure. The process for the latter can be problematic, as can some remaining cross-subsidies between business customers. One of the outcomes of the Forum's work was a recognition by Scottish Water that business customers' views should be better incorporated into Scottish Water's performance assessment in future.

Following divestiture in England, the water undertakers were regulated using competition by comparison, and in Scotland a similar set of criteria were applied in order to use the English providers as benchmarks. Improvements were incentivised, just as happened with the private undertakers in England; Scottish Water was allowed to retain any outperformance within the period of any one price review. Comparison with England, and a rigorous approach to data collection, reporting and auditing, enabled the WICS to drive efficiency gains and in a 10 year period, Scottish

¹⁶ Most recently, Anglia Water succeeded in winning the public sector contract from Business Stream, for all local authorities, hospitals and educational establishments.

¹⁷ 2005 Act, ss.4-5.

Water's performance across a basket of measures increased from the bottom of the English comparators, to the upper quartile. This has been a commendable process, achieving private sector efficiency in the public sector, and is one of the reasons why the system in Scotland might be of interest to other countries carrying out their own reforms.

The early strategic reviews in Scotland were both data-intensive and adversarial. As might be expected where supply had been provided by local authorities, without any accounting separation and with other, higher profile commitments, the data was often disputed, or simply unavailable. Further, the relationship between Scottish Water and the WICS was problematic, resulting in 2006 in a failure to agree a business plan and the resignation of Scottish Water's chairman.¹⁸ In the 10 years since then, much has changed, as evidenced by the progressive reductions in the volume of data produced in successive strategic reviews.¹⁹ It is often argued that regulation, rather than ownership, is the key to improving performance and in the 1990s that argument was made in relation to the English undertakers (Renzetti and Dupont, 2006). If so, then in the early years of this century Scotland appears to provide evidence for that from the public sector, rather than the private. However the 2015 review was qualitatively, as well as quantitatively, different. In part, this arose from the desire to reduce the regulatory burden; and in part, from developments in thinking around governance.

3. Governance, Representation and the Regulatory Burden

¹⁸ Scottish Parliament Environment and Rural Development Committee Hearing on Scottish Water 22 March 2006 col.2937-2953 available at <http://archive.scottish.parliament.uk/business/committees/environment/or-06/ra06-1002.htm#Col2937>

¹⁹ Links to the full documentation from all the strategic reviews since 2002 available at http://www.watercommission.co.uk/view_Price%20Setting.aspx

Governance is pervasive in relation to water resource management (Rogers and Hall, 2013; OECD 2015a) and to water services regulation (Stern and Holder, 1999; OECD 2015), but it is fundamentally a political concept (Stoker, 1998). It is a multi-faceted understanding of social organisation that is wider than the state; it may fill gaps where government authority is weak, or provide counter-balance where the state is over-strong. Different authors have identified different governance attributes, but from a legal perspective three core elements contributing to good governance would be transparency (access to information), participation, and accountability (access to justice). These attributes are often analysed in relation to participation in environmental decision-making, for example under the Aarhus Convention (UN/ECE, 1999) or the Rio Declaration (UN, 1992).

In relation to water resource management, good water governance is often tied into improved public and stakeholder participation, for example in river basin planning processes, where there is an understanding that water users should be involved in management decisions (OECD, 2015a).

Participation was one of the 'Dublin Principles' (Dublin Statement, 1992) and is widely discussed in the literature and practice. Governance is also highly relevant to water services provision, where it can be used to refer to the broad regulatory system and also to the relationship between service providers, regulators and customers. Transparency, participation and accountability are again essential structural mechanisms to deliver good governance, and transparency and accountability can both be seen as formal provisions which the law can enable; insofar as the rule of law is effective, then information will flow and there will be functioning mechanisms to achieve justice.

Participation though is much more complex – whether in service regulation, resource management or any other area of decision-making – and that is especially true if efforts are to be made to go beyond formal consultation, or working with major corporate or institutional stakeholders, and actually enable engagement of citizens in decision-making (see, for example, Arnstein, 1969; Fung, 2006; and specific to water, UNDP, 2013). Participation requires information and it requires redress for failure, but those preconditions are not sufficient. Participation is also time-consuming and requires effective social mechanisms. Further, in relation to water services especially, although data

may be supplied, that data is often very complex, highly specialised, and difficult to interpret. This is true both of the data around the service provision and the data around its economic regulation. Therefore active engagement of citizens is especially difficult to achieve. Yet that participation is vital. Water services are a basic need and almost always delivered by monopoly, whether public or private. There are significant asymmetries of information – and the consumer is least informed of all – yet the consumer both pays the price and suffers the service standards. Consumers might, if enabled, have meaningful views on the trade-offs that are inevitably made between prices and standards in the broadest sense. The questions then are how to engage consumers, and how to ensure that the information provided to enable that participation is useful as well as available.

Although the difficulties with participation might make it less attractive as a part of formal decision-making, economic regulation is always problematic and resource-intensive. In England, concern about the regulatory burden and the volume of data collected and reported on was one driver of change (Cave, 2009), as was the need to give a greater voice to customers (Gray, 2011, OFWAT 2011). Partly, this was prompted by a recognition that the English water and sewerage undertakers were reaching what might be termed a 'regulatory plateau'. In England, the water and sewerage undertakers were assessed and scored against a set of 17 measures (the Overall Performance Assessment). The same measures were reported on in Scotland to allow benchmarking. However, as technical compliance rose, it becomes difficult to use these measures to force continued improvement. In England the regulator moved away from both the Overall Performance Assessment and the detailed reporting on and assessment against similar data sets. Amongst other reforms, the regulator introduced a Service Incentive Mechanism which rated customer satisfaction. This new focus on customers also reflected work by Littlechild, who had been instrumental in developing the price cap model in the 1980's and 1990's, and was now considering whether a better approach might be an increased focus on the customer and what the customer might want from the service provider, using the sorts of negotiated settlements common in utilities' regulation in some US states (Doucet and Littlechild, 2006; Littlechild, 2008, 2011). Such a customer-oriented approach fits well

with an emphasis on governance frameworks. As well as the Service Incentive Mechanism, it was decided to establish Customer Challenge Groups, which would be part of the business planning process for the English undertakers (OFWAT 2011). The Challenge Groups, unlike the Forum in Scotland, were not representative of customers but rather composed of various agencies and regulators, such as local authorities, the Environment Agency, etc., as well as the Consumer Council for Water (a statutory body representing customers in England and Wales and with a similar remit to that now held by Citizens' Advice in Scotland).²⁰

The regulatory plateau and the regulatory burden were both drivers for reform in England, but there were other pressures. Whereas Scotland has just one major supplier, in England there are ten large water and sewerage undertakers, nine water-only companies, and a number of small operators and licensed suppliers, each with their own geographical area and variable licence conditions.²¹ Thus the regulator's role is inevitably more complex. Further, as English providers are fully divested, there is an additional pressure from investors, whether lenders or shareholders, to achieve a good return. WaterUK (a trade body) estimated in the run-up to the 2014 price review that on average, investors received around 5% on their investment (WaterUK, 2013). That would be a good return for a private investor in current times, but more importantly perhaps is a reasonable average in an industry like water. As an essential service and a natural monopoly (whether public or private) it should be a stable investment over time. However, any average can mask significant disparities, and private monopolies are always open to criticism. In the run-up to the 2014 price review, there were concerns that the boards were (unsurprisingly) seeking commercial advantage for their investors at the expense of customers' interests, *inter alia* by manipulating (lawfully) the tax regime or the balance between equity and debt (see, for a critical appraisal, Turner, 2013). This is the natural

²⁰ See generally, and for links to the archive documentation <http://www.ofwat.gov.uk/regulated-companies/price-review/price-review-2014/customer-engagement/>

²¹ See <http://www.ofwat.gov.uk/industryoverview/today/watercompanies>

tendency of firms, but it is also the regulator's role to control that tendency. When the Challenge Groups were established, the understanding was that if companies could reach agreement with their customers, this would be evidence of their eligibility for 'enhanced standing' – an expedited regulatory process. However, although most companies did reach agreement with their Challenge Group, OFWAT only granted advanced standing to two companies (OFWAT 2014). As will be examined below, the Customer Challenge Groups were not afforded the same degree of regulatory backing that was made available to the Customer Forum in Scotland.

4. The Customer Forum – Establishment and Remit

Influenced by these developments in England, and the emerging literature, it was agreed to establish a body known as the Customer Forum in Scotland. The intention was to create a less adversarial, more consensual model for agreeing aspects of the strategic review of charges, and the Forum was set up under a cooperation agreement signed by the WICS, Scottish Water and the National Consumer Council.²² The agreement set out the remit of the Forum and made it clear that Scottish Government, and all the regulators, would be part of the process.

It might be helpful to briefly outline the various bodies already involved in representing consumers of water services in Scotland. Until 2010, there was a designated body representing customers of Scottish Water – the Customer Consultation Panels, also known as WaterWatch.²³ Under the 2005 Act these had various powers of investigation in relation to complaints etc., and they also had a role in relation to developing the policy framework. Whereas the WICS has a general duty to promote the interests of the customers, the Panels had the duty to represent their views and interests. They had a duty to publish reports and powers to make recommendations, and the Convenors of the Panels

²² Available, with other relevant documents, at

http://www.watercommission.co.uk/view_CustomerForum.aspx

²³ The Panels were established under WISA, and their powers extended in the 2005 Act.

had a duty to investigate complaints, and a power to obtain information, and could make representations. There was a duty of cooperation between the Panels and the WICS.

In 2010, the Panels were wound up. There was a perceived need to separate the policy function from the complaint function, and their advocacy and policy-related functions were transferred (at that point) to the National Consumer Council.²⁴ (The National Consumer Council in Scotland was known as Consumer Focus, and then as Consumer Futures, during the existence of the Customer Forum.) Their investigative powers for second-tier complaints (i.e. those which had been addressed, but not resolved, by Scottish Water internally) were transferred to the Scottish Public Services Ombudsman. Subsequently, due to changes in consumer protection at UK level, the powers residing with the National Consumer Council in Scotland were again transferred, this time to Citizens' Advice Scotland. Thus it has been a challenging period of rapid change which certainly affected the work of the Forum and its relationships with the regulators.

The Forum's costs were met by the WICS, which in turn is funded by a levy from customers. It had nine members – a Convenor, appointed by all parties to the agreement; five members nominated by the Consumer Council; two members representing the licensed providers; and one from the business sector (initially from the Federation of Small Businesses, and later from the Scottish Council for Development and Industry). All members were appointed under normal public sector appointment rules and conditions. In addition, we were joined by staff from the Consumer Council, who had been staff with WaterWatch before that and have since transferred to Citizens' Advice, providing some long-term continuity. We also had some policy support from Scottish Government and in our legacy report this was one of the things we identified as a learning point (Customer Forum 2015); more consistent and sustained support of that type (not necessarily from Government, but with the specialist knowledge we lacked) might have been useful. However support from the WICS especially,

²⁴ Public Sector Reform (Scotland) Act 2010 asp.8.

and from Government, made up any real deficiency, although our Convenor was possibly required to give rather more time to Forum business than he might have expected.

The Forum was not intended to reflect the customer base directly; there was no intention that Forum members should include members of disadvantaged groups, for example (although five of the nine were women, but this was not a design specification). Nor were we expected to have specialist knowledge of the industry – of the ordinary members, only two had any specialist water sector knowledge. Rather, it brought together a group of people with a wide set of relevant skills, including a retired senior civil servant, a lawyer specialising in consumer law, a marketing specialist, and an engineer who had previously served on boards of water companies and environmental regulators. The two representatives from the licensed providers did of course have specialist expertise and as one of them was from an English supplier, he also brought valuable comparative knowledge of the industry generally, the price review, and the inclusion of the customer voice, in England. The Convenor was a former Minister in the Scottish Government, and Member of the Scottish Parliament, who had also convened a large local authority and been involved in many other public (and private) bodies and enterprises. The intention was to draw together people who would be able to understand the complex evidence and data presented, engage sensibly but not as specialists with both Scottish Water and their regulators, and ask – sometimes repeatedly - the questions that a consumer might ask. Especially, we asked Scottish Water – ‘why is that (proposed action) in the interests of your customers?’ The asking of that question essentially forced Scottish Water to provide explanations of things that would never need explained if the dialogue remained between themselves and the regulators, all of whom had the specialist knowledge we lacked. One further and important advantage of being there as individuals was that we had no vested interests or institutional positions to maintain. It was also helpful that we did not have an advocacy or policy-related function – we were very specifically working within the existing policy framework as set out by Government, rather than lobbying to change that frame.

The cooperation agreement shows that the Forum was intended to work with all the regulators and Scottish Water. The Forum would be involved with Scottish Water's own customer engagement programme and also be able to commission its own customer research if required, as well as bringing in specialists of various types to give advice.²⁵ It would have an 'engagement (sub)-committee' that would negotiate directly over aspects of the draft business plan. The WICS' view was that a more consensual process would be more productive; and negotiations with the formal regulator, *de facto* less productive; and they set out their thinking in early documentation on the process for the 2015 review (WICS 2013a).

5. An Expanded Remit

At the start, the Forum was expected to be involved only in what might be described as 'discretionary spending' – that portion of Scottish Water's costs that do not relate to mandatory functions. Mandatory functions would include all legal obligations, including EU law on drinking water, wastewater treatment, and other (EU or national) environmental requirements; and anything else required by law or within a Government Direction. The remaining discretionary spend was inevitably very small. It soon became clear that this was an ineffective way to proceed, especially as the timing of mandatory spending could make a significant difference to customers and the service they received. As the Forum progressed its discussions with Scottish Water and the regulators, the WICS considered that the Forum could play a wider role.

This may have resulted in part from the Forum's developing relationship with Scottish Water.

Although there were a number of challenging meetings – at the start and throughout the process – there was involvement of Scottish Water staff at the highest levels. This meant that agreement did

²⁵ Not specifically on the water industry; for example, we obtained advice on water poverty, and on the impacts of different measures of inflation.

not subsequently need to be sought from more senior staff, and also that the whole organisation knew that the Forum was relevant. Scottish Water began to produce a series of 'Service Improvement Reports' which analysed and explained their activities.²⁶ Their own staff subsequently agreed that it had been a useful exercise for them to develop such reports in terms which an intelligent layperson would be able to understand; that sort of explanation would be vital to any customer body attempting the sort of work that the Forum did. The Service Improvement Reports were later published as annexes to Scottish Water's business plan (Scottish Water 2014).

In addition the WICS was providing the Forum with a series of guidance notes,²⁷ and their own thinking on the wider regulatory process was developing. The regulatory 'plateau' was relevant to Scotland, quite apart from the loss of benchmarks when the English companies stopped reporting on the basket of measures in the Overall Performance Assessment. Effectively, a relatively stable set of standards are currently being met, in a relatively stable environment, with low inflation and minimal price increases. Therefore, benchmarking of technical improvements becomes less relevant – but identifying, and meeting, the wishes of customers becomes more important, around discretionary spend and around the phasing of improvements. Related to this was recognition of the desirability of moving to a 'smoother' regulatory process. Although a price cap system with defined time periods has certain advantages, it also has disadvantages. There is intensive activity in the early part of a pricing period, but towards the end there may be a reduction in investment, then a rapid start-up at the beginning of the next period, leading to difficulties for the supply chain. Long-term planning is important for security of supply, and Scottish Water is required to produce 25-year plans for water resources. They now also produce a 25-year 'strategic projection', (Scottish Water 2014a) and the six year review period sits within that. Further, in the current period, there will be an investment review

²⁶ Covering everything from drinking water supply, to carbon management.

²⁷ Available at http://www.watercommission.co.uk/view_CustomerForum.aspx

at the midway point, allowing some readjustment to the capital programme and other commitments in 2018 (WICS 2014).

As part of their guidance, the WICS took a new approach to evidence of financial performance. They introduced a set of 'financial tramlines' which indicate to Scottish Water and its regulators if it is outperforming, or underperforming, in cash and capital value terms; and the levels at which there might be concern that this is the trend. As long as Scottish Water's business plan and performance are within the 'tramlines', then the regulators can be assured. Over a relatively short period of time, it became clear that this would allow the Forum, and its engagement committee which negotiated directly with Scottish Water over their business plan, to effectively finalise the business plan within the limits and constraints set by the WICS. The tramlines are specifically mentioned in the current principles of charging, reflecting the Government's involvement in, and support for, the process (Scottish Government 2014a). Government will decide on what should happen in the event of any outperformance above the top line (and Government, with the WICS, on what remedial steps are necessary if there is a risk of underperformance). It is also intended that the management of any such over- or under-performance would be discussed with customers (such as the Forum, or whatever body may replace the Forum in the future).

The Forum was not a statutory body, and this allowed a degree of flexibility, though it did raise questions as to accountability. From the start, the Forum took the view that ultimately, we could be called to account, if necessary by the Parliament – and indeed Forum members were received by the relevant Parliamentary Committee, our activities discussed and evidence given by the Convenor about our work. It is also important to note that the Forum did not in any way demit from the WICS' primary duty to make the determination, and the statutory powers remained vested in all the regulators. The 'Quality and Standards' process remained in place and the Forum was not involved with that other than to be informed of its progress and outcomes. However, a critical point was reached when the WICS decided that if the Forum could agree a business plan with Scottish Water

that allowed for all the mandatory requirements, met Government objectives and principles of charging, and fell within the financial parameters, WICS would be 'minded to accept' that entire agreement in its determination of charges (WICS 2013a). (For a detailed chronology, see the Forum's legacy report (Customer Forum 2015) and Littlechild, 2014). In Scotland, we knew that the WICS was actively supporting the process. However we also knew that if the engagement committee and Scottish Water did not reach agreement, then both parties would be required to explain this failure and the reasons for it to the regulators. Taken together, these were powerful motivators for both sides to encourage positive negotiation. This was very different to the situation in England with the Customer Challenge Groups. In many cases, English providers did succeed in reaching agreement with the Customer Challenge Groups, but nonetheless the draft business plans so agreed did not meet with regulatory approval (OFWAT 2014). It is arguable that agreement was reached only because the Forum did not challenge Scottish Water as strongly as the WICS might have done. Yet that argument would imply that WICS did not remain in control of the regulatory process, as its statutory functions require. The documentation makes it clear that WICS would not have agreed to a settlement that did not meet its own requirements (WICS 2013a, 2014).

With this support and regulatory commitment, it was possible for the Forum's engagement committee to reach agreement with Scottish Water on a draft business plan well in advance of the expected timeline. As part of this, it was agreed that in future, SW's performance measures will give (progressively) more weight to customer satisfaction, with the introduction of new Scottish customer experience measures (separately for household and business customers) with some of the features of the Service Incentive Mechanism, but tailored to the Scottish situation and especially a

different billing process.²⁸ However, in order to measure trends, Scottish Water will also continue to report on, and have targets for, a slightly modified OPA.

6. Reflections on the Process: Lessons Learned and Future Steps

When first asked to apply to be a member of the Forum, as an academic working in the area, I saw it as an exciting opportunity to be involved in a new stage of the regulation of water services in Scotland, and further, a development that might be of use in regulating water services in other places. I was one of the two ordinary members with some knowledge and understanding of the sector, as well as the regulatory and governance contexts. At the start, there were questions around the Forum's role and especially its non-statutory existence. Whilst that gave the Forum greater flexibility, we did discuss throughout the process, both internally and with all the regulators, how that might affect our legitimacy and accountability.

Another recurrent conversation was around the composition of the Forum. Should it have been designed to reflect the customer base more precisely, such as hard-to-reach groups? We generally took the view that the correct approach (for the non-business representatives) was to be 'informed laypeople', but nonetheless laypeople who brought a mix of relevant skills and expertise. Littlechild (2014) has reported on the roles of both our Convenor and of the Chief Executive of Scottish Water and his senior team, and it is not possible to legislate (or contract) for personalities; but on the Forum side, careful selection was helpful and would also be important to any similar body in future. On the business side, both the Licensed Providers and the business customers were properly involved but the latter group especially would benefit from additional representation.

²⁸ As billing arrangements are very different in Scotland, where water charges are collected with local taxation, and as a large part of the Service Incentive Mechanism relates to customer complaints over billing, its direct use in Scotland would not be possible.

Something we did not do, or try to do, was engage with the technical aspects of economic regulation as such, for example assessing efficiency or the cost of capital. We were not economists. A panel such as ours could have economists as members, but that might lead to some duplication or even conflict with the full-time role of the WICS and its staff, which we could never replicate. Perhaps this is just the lawyer's natural reluctance to engage with economics, and perhaps the same arguments apply to us engaging in relation to consumer protection, but arguably, the latter is a better and more realistic use of the external layperson.

As an academic, I have observed, and commented on, Scottish Water (and its predecessors), the price setting process, and the broad regulatory framework, for many years. It was fascinating to see that process from the inside, acquiring a new depth of understanding – of technical issues and regulatory processes; I hope that my wider comparative work has benefited as a result. It was a most enjoyable activity and if the Forum is to be reconstituted and I was asked to continue to serve, I would not hesitate in accepting. The future of the Forum was also a topic of discussion throughout the process, and indeed continuing now. Undoubtedly we all hoped the project would be seen as successful and beneficial, as I think it has been; and therefore might merit continuation. Several aspects of our work with Scottish Water indicated areas where not necessarily the Forum, but certainly some customer input would have a role, including developing new service improvement mechanisms for business customers and potentially, being part of the discussions on managing any outperformance above the guide limits in the tramlines. Both the Scottish Government and the regulators are considering this, and meantime, some Forum members continue to advise the WICS.

If the Forum was to continue, then it might not be in the same form; various options exist. It could be put on a statutory footing, in which case a decision would need to be made as to whether it would be principally associated with WICS, with the relevant consumer body, with Scottish Water itself, or (as was the case) still under an agreement between the three. The latter would be the most complex to provide in statute, but perhaps the most comprehensive. The risks associated with being

‘owned’ by Scottish Water would include both ‘capture’ of Forum members and potentially disruption by a less positive management team. As an academic lawyer, My preference (if it was a choice) would probably be for alignment to the WICS – but I recognise that would be my preference and members more closely involved in consumer protection work (as some members would surely be) might see a different approach. Whilst the WICS has the responsibility to set prices and agree the business plan (hence my preference for WICS), and a general duty to represent customers, the broader policy advocacy role over water services is held by (currently) Citizens’ Advice Scotland. The rapidly changing consumer landscape in Scotland, both during the price review and ongoing, makes it more difficult to properly assess where the Forum should sit in relation to that advocacy role, and in relation to the representation of marginalised groups (including, perhaps, those who are not served by Scottish Water and therefore not really considered in our work or the business plan). There are also interesting questions around the regulation of other utilities or networked monopolies in a small jurisdiction such as Scotland. The current Scotland Bill²⁹ devolves consumer responsibility, but not competition law, and discussions are underway in Scotland to identify mechanisms that could be put in place to implement these changes (Hill, 2014); it is clear that the Forum is being looked at, not just in relation to water, but as a potential model in other areas. That changing consumer landscape might have other implications for the Forum and initiatives like it. Whilst we were given extensive inputs from WICS especially, we also had (intermittent) help from civil servants. Some advisory input with expert knowledge of the sector to our internal work was recognised as being very helpful and something that a future Forum might benefit from at an earlier stage. However in terms of our internal membership we might have acted differently if the primary inputs had been from the consumer protection, rather than the regulatory, side. For myself, as a lawyer, I would think on balance that the most important inputs came from WICS but if a new consumer body was created, the Forum might sensibly be located within its broader remit.

²⁹ Scotland Bill 2015 HL Bill 73 2015-16

7. Conclusions

Going forward, the Forum officially came to an end under the cooperation agreement in March 2015, and no decision has yet been made as to what, if anything, will take its place. The Government, WICS, Scottish Water and the other regulators are keen to retain a strong customer focus in the 2018 mid-point investment review and subsequent strategic reviews. The Forum's legacy report did canvass various options, including placing the Forum on a statutory basis; and Scottish Water's business plan identifies several ongoing initiatives around performance monitoring which could be taken forward by a body with a role similar to the Forum.

Whilst the intention behind the Customer Challenge Groups in England was similar, and within a similar broad regulatory process, the Forum could be seen as more successful. Undoubtedly it is easier to regulate a single entity than multiple entities, and that is a question of scale. It is difficult, to say the least, to envisage a large jurisdiction of 50 or 60 million people, such as England, with a single integrated water supplier, whether public or private. However multiple entities should also be helpful, to enable benchmarking. Another clear area of difference was in the composition of the Forum. Although not intended to be directly representative, nonetheless members were customers, rather than regulators or industry experts. In the English Customer Challenge Groups, consumers were represented through other bodies, such as the Consumer Council for Water, local authorities and Citizens' Advice. A panel of laypersons is certainly transferable regardless of scale or location, and if sufficiently well-informed and well-supported, can bring a perspective that might otherwise be lacking. Subjecting members to a public sector appointments process was also important, to ensure independence and legitimacy.

Information and support to the Forum came from various sources, including Scottish Water itself, the Government and all the regulators. Without a doubt the support and input of the WICS was critical, as is quite appropriate given that the WICS is the principal locus of the regulatory authority

and would ultimately have the power to impose a determination under the statutory framework. The WICS' view that customer engagement could provide a smoother, swifter and less adversarial result was borne out by the Forum reaching agreement with Scottish Water several months in advance of the statutory timescale. The WICS' 'minded to accept' position was an important driver, but so too was the obligation on the parties to explain any failure to agree. The development of the 'tramlines' and other aspects of the financial settlement were and are important, as they give a set of parameters within which there is some flexibility; this approach to price setting is also transferable to many different ways of regulating utilities, not just in water. That is also true of the 'smoothing' of the regulatory process, across different time frames.

It is arguable that the process in Scotland since 2002 evidences the cyclical nature of regulation (in any sector). The adversarial and contested settlements of the early years were data-intensive and demanding of resources from both the regulators and the entities. Through successive price reviews, as the data was better established and there was less scope for dispute, the contentious nature reduced. Hence over time the regulatory burden reduced, making it easier for the WICS (with the other regulators) to step back from the formal enforcement process and allow a body such as the Forum to step in.

It is also possible that Scottish Water's public nature was a positive asset to the process. Traditionally, public monopolies are seen as tending to inefficiency, in different ways and for different reasons than natural monopolies in the private sector. Regulation therefore is necessary to both, and regulation forced efficiencies upon Scottish Water in the 2000's, just as it had in England in the 1990's. However it is at least arguable that a public supplier has fewer internal conflicts and fewer competing demands, and that this may make it easier to achieve a transparent regulatory settlement that meets multiple public goals over time.

Yet that does not mean that a body such as the Forum can only work within the public sector, or indeed at a 'high point' in a long-term regulatory cycle, where regulator and entity are on relatively

cooperative terms. Whilst both of these factors may have played a part, so too did the empowerment of the Forum, by all of the regulators and by Government; and its essential nature as representing customers directly; these factors can more easily be replicated. Innovations such as this will always need to be designed with an eye to the specific needs and capacities of the jurisdiction in question, but as part of a broader governance model it is at least arguable that something like the Forum could play a role in utilities' regulation in many different settings.

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